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Nos. 12,300 and 12,301

IN THE

United States Court of Appeals
For the Ninth Circuit

WALTER D. ACKERMAN, JR., individually and as
Attorney General of the Territory of Hawaii, and
JEAN LANE, individually and as Chief of Police of
the County of Maui, *Appellants,*

vs.

INTERNATIONAL LONGSHOREMEN'S & WAREHOUSEMEN'S
UNION, a voluntary unincorporated association and
labor union, et al., *Appellees.*

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Upon Appeal from the United States District Court
for the District of Hawaii.

BRIEF OF AMICUS CURIAE.

THE BAR ASSOCIATION OF HAWAII,
Honolulu, T. H.

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BRIEF OF AMICUS CURIAE.

INTEREST OF THE BAR ASSOCIATION OF HAWAII.

This brief of The Bar Association of Hawaii has been made available to all members of the Association for perusal. By vote of the Association at a special meeting thereof, it has been filed herein.

The decision filed by the United States District Court for the District of Hawaii¹ raises certain questions regarding the relationship between the courts of the Territory of Hawaii and the courts of the United States. Specifically, the decision holds that the United States District Court for the District of Hawaii may intervene in pending criminal proceedings before the territorial courts and stay said proceedings whenever the court finds circumstances exist indicating that the prosecutions are not being carried on in good faith, or where the enforcement of territorial statutes will result in the limitation of the exercise of certain rights provided for by federal law and where irreparable damage will result from the enforcement of said territorial statutes.

The District Court herein also holds that in the stay of such territorial court proceedings, it may pass upon

¹The trial court functioned as a statutory three-judge court under 28 U.S.C. Sec. 2281 and found itself properly constituted as such (R. 412-432). It also, in the alternative, found itself to be a properly constituted United States District Court for the District of Hawaii sitting *en banc* (R. 432-438). The subsequent decision of the United States Supreme Court in *Stainback v. Mo Hock Ke Lok Po*, 336 U.S. 368, that the Territory of Hawaii is not a "state" within the meaning of 28 U.S.C. Sec. 380 (revised without any change of importance in this matter to 28 U.S.C. Secs. 2281, 2284). The Supreme Court of the United States adopted the view of The Bar Association of Hawaii advanced in its *amicus* brief filed at the request of the three-judge District Court. The effect of this decision is to eliminate the first ground of jurisdiction relied upon.

the constitutionality of the territorial statutes irrespective as to whether a determination thereon has been made by the territorial courts. The District Court also holds it may review the decisions of inferior and superior territorial courts, and may make determinations as to the constitutionality of jury selections.

Since these determinations seriously affect the jurisdiction of the courts of the Territory of Hawaii as components in an independent judicial system, The Bar Association of Hawaii desires to direct its brief to the question of the relative jurisdictions of the territorial and federal courts, the relationship between them and the dependence upon, or independence of, one judicial system to the other.

In addition, to the extent that the opinion filed by the District Court, either directly or by innuendo, reflects upon the character or integrity of any judges of the courts of the Territory of Hawaii, The Bar Association of Hawaii, comprised of attorneys who are officers of that Court, has an interest and responsibility² in defending the character of the incumbents so reflected upon, and in securing a correction of the record in that respect.

No consideration will be given herein to the constitutionality of any territorial statute or of any method of selection of jurors in the Territory of Hawaii, but

²" . . . Judges, not being wholly free to defend themselves, are peculiarly entitled to receive the support of the Bar against unjust criticism and clamor . . ." Canons of Professional Ethics, The American Bar Association, Canon 1.

the brief is to be confined to the jurisdictional issues raised and the factual findings upon which the court below justifies its intervention to stay territorial court proceedings.

SUMMARY OF ARGUMENT.

A United States District Court may not enjoin criminal proceedings pending in state courts because of congressional prohibitions against such intervention. This is so, irrespective of the circumstances surrounding the state court criminal proceedings, the methods or motives of state prosecuting officers, or any other factors.

While the legislative prohibitions against federal intervention in pending proceedings in state courts may not extend *in haec verba* to territorial courts, the relationship between the federal courts and the courts of the Territory of Hawaii is such as to require that the courts of the Territory be permitted to adjudicate pending cases free from federal court interference. All the basic reasons for state freedom from federal court intervention apply with equal or greater effect to the relations between the courts of the Territory of Hawaii and the federal courts. The necessity for a judicial system in the Territory of Hawaii free from federal court interference has been judicially recognized.

Federal courts have intervened to stay threatened criminal proceedings for the enforcement of state laws only where exceptional circumstances have been

found, which circumstances have legally justified such intervention. Similarly, exceptional circumstances must be found to justify intervention by the United States District Court for the District of Hawaii to stay the threatened enforcement of territorial statutes. The record and evidence in the instant case fail to show the exceptional circumstances which justify intervention by the district court in staying the threatened enforcement of territorial criminal statutes. The findings made by the trial court to support its exercise of jurisdiction in this regard are unsupported by the evidence in the record.

With no basis for intervention, the district court acted with impropriety in enjoining the enforcement of territorial statutes staying prosecutions pending in the territorial courts, reviewing the decisions of the inferior territorial courts on the constitutionality of the method of the selection of the grand jurors, and of the Supreme Court of the Territory of Hawaii on the constitutionality of a territorial criminal statute. Because of such impropriety and lack of inherent jurisdiction in the district court, the judgment of that court should be reversed.

I.

THE ISSUANCE OF A STAY BY THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF HAWAII AGAINST THE PROSECUTION OF PENDING CRIMINAL PROCEEDINGS IN THE COURTS OF THE TERRITORY OF HAWAII WAS UNDER THE CIRCUMSTANCES OF THIS CASE IMPROPER; BECAUSE OF SUCH IMPROPRIETY THE INJUNCTION MUST BE DISSOLVED AND THE DECREE REVERSED.

Sections 2281 to 2284, inclusive, of Title 28 U.S.C., provide that injunctions may be issued by three-judge district courts of the United States against the enforcement of state statutes under certain circumstances. This extraordinary jurisdiction is, as shall be shown, to be narrowly confined.

As a result of the case of *Stainback v. Mo Hock Ke Lok Po*, 336 U.S. 368, the jurisdiction of the courts of the United States to enjoin the enforcement of allegedly unconstitutional statutes of the Territory of Hawaii does not rest upon the express statutory provisions for the three-judge district courts, but if jurisdiction does exist in a district court of the United States to enjoin the enforcement of territorial statutes, it is by virtue of inherent equity powers of the United States district court.

While the decisions of the Supreme Court of the United States involving the impropriety of injunctions by federal courts against the enforcement of unconstitutional legislation, other than federal legislation, have involved state statutes or constitutions rather than territorial laws, the principles laid down in such cases, although not controlling, should furnish this Court a persuasive guide for the determination of the propriety of the action of the court below.

A. Inherent powers of federal equity courts to enjoin criminal proceedings.

A line of supreme court cases dealing with the problem of the inherent powers of federal courts sitting in equity to enjoin criminal proceedings has led to certain well-defined principles which may be stated as follows:

1. An equity court will not ordinarily enjoin the enforcement of a criminal statute, the person proceeded against having an adequate legal remedy in the criminal proceeding.

2. An allegation of unconstitutionality of a criminal statute, the enforcement of which is sought to be enjoined, does not furnish a proper basis for an equity court exercising its powers. If the statute is unconstitutional, that fact may be urged as a defense in the criminal proceeding.

3. Where a statute sought to be enjoined in the federal courts is other than a federal statute, the proper forum for the determination of its constitutionality is a court of the jurisdiction whose statute it is. A federal court is not a proper forum for the determination of the constitutionality of a non-federal statute.

4. An injunction may be had in a federal court against the enforcement of an unconstitutional state statute only where the circumstances are exceptional and there is a threat of irreparable, great and immediate injury as a result of the enforcement of the statute.

A. F. of L. v. Watson, 327 U.S. 582;

Douglas v. Jeannette, 319 U.S. 157;

Williams v. Miller, 317 U.S. 599;

Watson v. Buck, 313 U.S. 387;

Beal v. Missouri P. R. Corp., 312 U.S. 45;

Spielman Motor Sales Co. v. Dodge, 295 U.S. 89.

The fourth principle stated above is a development of the rule that “‘equitable jurisdiction exists to restrain criminal prosecutions under unconstitutional enactments, when the prevention of such prosecutions is essential to the safeguarding of rights of property’” enunciated in *Tyson & Bro. v. Banton*, 273 U.S. 418, 428. *Cline v. Frink Dairy Co.*, 274 U.S. 445, 452.

Following the *Cline* case, the presently worded principle has been set forth in six supreme court decisions wherein a stay of the enforcement of a state statute was sought. In all, injunctive relief was denied. *A. F. of L. v. Watson*, 327 U.S. 582; *Douglas v. Jeannette*, 319 U.S. 157; *Williams v. Miller*, 317 U.S. 599; *Watson v. Buck*, 313 U.S. 387; *Beal v. Missouri P.R. Corp.*, 312 U.S. 45; *Spielman Motor Sales Co. v. Dodge*, 295 U.S. 89.

In the most recent case, *A. F. of L. v. Watson*, it was found that the test for the exercise of equitable powers of the federal court to enjoin the enforcement of a state enactment had been met, but the district court was ordered to refrain from exercising these powers pending an interpretation of the questioned amendment to the state constitution by the state supreme court. A dissenting opinion found a want of jurisdiction in equity and a failure to meet the enunciated test.

In the other cases, relief was denied for lack of a proper factual showing necessary for the exercise of equitable powers of stay. There were no exceptional circumstances found in those cases wherein the enforcement of a state enactment threatened great, immediate and irreparable injury.

It is clear that the equitable test is strictly interpreted and rigidly required. Exceptional facts must be found to justify federal intervention.

B. Statutory federal jurisdiction as basis for the exercise of equity powers to stay enforcement of unconstitutional state enactment.

The fact that federal jurisdiction over the cause is had under statutory provisions does not affect the doctrine that prior to a federal court exercising equitable powers of intervention to stay enforcement of a state statute, proof must be had that the circumstances are exceptional and that a failure by the United States court to intervene will clearly and imminently be followed by irreparable injury.

In *A. F. of L. v. Watson, supra*, the jurisdiction of the federal court was found in Section 47(8) of Title 28 U.S.C. (proceedings arising under a law regarding commerce). In addition, a further finding was made that the facts were such as to warrant intervention to stay the enforcement of the state constitutional provision, but that federal action should be deferred until the challenged provision was first construed by the state courts. Jurisdiction under 41(8) did not suffice *per se* to permit intervention.

In *Douglas v. Jeannette*, *supra*, federal jurisdiction was based upon Section 41(14) of Title 28 (suits to redress deprivation of civil rights, the right which was threatened by state law arising under Title 8 U.S.C., Sec. 43, a civil rights act). Despite the jurisdictional basis, relief was denied.

In *Watson v. Buck*, *supra*, federal jurisdiction rested on Section 41(1) of Title 28 (a claim arising under federal law, *Gibbs v. Buck*, 307 U.S. 66). Injunctive relief was denied due to a failure of a “. . . claim showing that an injunction was necessary in order to afford adequate protection of constitutional rights . . . Such ‘exceptional circumstances’ and ‘great and immediate’ danger of irreparable loss were not here shown.” 313 U.S. 387, 401.

In *Beal v. Missouri P. R. Corp.*, *supra*, jurisdiction was grounded on diversity of citizenship (Tit. 28 U.S. 41(1)). No injunction was had because of the failure of proof of irreparable injury flowing from the threatened prosecution.

It is clear that whether the jurisdiction of the federal court over the cause is based upon the civil rights acts, diversity of citizenship provisions, or any other statutory basis, relief staying the enforcement of state statutes will be granted only where the equitable test set out for this type of case has been met.

Hague v. C.I.O., 307 U.S. 496, is not to the contrary. There an injunction was sought against the enforcement of municipal ordinances prohibiting public assemblies without permits. The director of public safety

had discretion to refuse a permit to prevent disorderly assemblies. The course of conduct complained of consisted in an alleged conspiracy to keep labor unions out of the city. Persons distributing printed matter on the streets were arrested and forcibly removed beyond the city limits. Unlawful searches, arrests and prosecutions were had. Permits to hold public meetings were regularly denied. Jurisdiction of the cause was found in Tit. 28 U.S.C. Section 41(14) (denial of constitutional rights). No discussion is had in the case as to the propriety of the exercise of injunctive powers by the federal courts, although the facts do not permit of denial that unless such relief was granted great and immediate danger of irreparable loss would have occurred.³ The circumstances were certainly exceptional.

The *Hague* case is not one involving the use of federal injunctive powers to stay the regular enforcement through legal channels of allegedly unconstitutional state enactments. It is rather a case involving an injunction against the irregular and extrajudicial enforcement of unconstitutional ordinances through strong-arm methods.

Other Supreme Court decisions requiring a showing of irreparable injury immediately consequent upon the enforcement of allegedly unconstitutional state enactments as a prerequisite for injunctive relief in the

³The situation has been described "The bill of complaint in the Hague case, whereby the jurisdiction was to be adjudged, fairly bristled with allegations of fact showing an arbitrary, discriminatory and even violent deprivation of complainants' freedom of speech, press and assembly, all done by municipal officers of Jersey City under color of enforcing a city ordinance." Dissenting opinion, *Douglas v. Jeannette*, 130 F. (2d) 652, 661.

federal courts, irrespective as to what the basis of federal jurisdiction may be, include:

Spielman Motor Sales Co. v. Dodge, 295 U.S. 89;

Cline v. Frink Dairy Co., 274 U.S. 445;

Tyson & Bro. v. Banton, 273 U.S. 418;

Packard v. Banton, 264 U.S. 140.

C. Restriction on federal courts exercising equity power to stay pending proceedings in state courts.

Statutory limitations on the powers of federal courts to enjoin pending proceedings in state courts is of long standing. It first found expression in the Act of March 2, 1793, which supplemented the original judiciary act. It is there provided:

“ . . . that writs of ne exeat and of injunction may be granted by any judge of the supreme court in cases where they may be granted by the supreme court or circuit court; but no writ of ne exeat shall be granted unless a suit in equity shall be commenced, . . . nor shall a writ of injunction be granted to stay proceedings in any court of a state; . . . ”

(Act of March 2, 1793, Ch. 22, Sec. 5, 1 Stat. 334.)

The revision of 1878 continued the restriction with an exception provided for bankruptcy cases. In this form the enactment was retained through subsequent revision until 1948.⁴ Other statutory exceptions to the

⁴“The writ of injunction shall not be granted by any court of the United States to stay proceedings in any court of a state, except in cases where such injunction may be authorized by any law relating to proceedings in bankruptcy” (Sec. 720, Rev. Stat. 2 ed.). In 1911 this provision became Sec. 265 of the Judicial Code and later Sec. 379 of Tit. 28 of the U. S. Code.

blanket restriction against the federal courts interfering with state court proceedings by stays have been created. One such exception antedated the original act, the balance being subsequent thereto.

The original judiciary act of 1789 provided for removal of cases from state to federal courts with the responsibility in the state court from which a case was removed to proceed no further in the cause.⁵ It has been consistently held that federal courts may, by virtue of this provision, enjoin state courts from continuing with proceedings after removal. *French v. Hay*, 22 Wall. 250; *Bondurant v. Watson*, 103 U.S. 281; *Kern v. Huidekoper*, 103 U.S. 494. An injunction could not be had, however, by the federal courts, against the continuance of state court proceedings, where removal was had to the federal courts primarily for the purpose of securing the injunction. *Dial v. Reynolds*, 96 U.S. 340; *Lawrence v. Morgan's Louisiana & T. R. & S.S. Co.*, 121 U.S. 634.

Additional statutory exceptions permitting the federal courts to issue stays against the continuance of state court proceedings exist by virtue of the Act of March 3, 1851, limiting shipowners' liabilities (9 Stat. 635, 46 U.S.C. Section 41(26) now contained in Tit. 38 U.S.C. Section 2361). *Dugas v. American Surety Co.*, 300 U.S. 414; *The Frazier-Lemke Act* (Tit. 11 U.S.C. Sec. 203(O)); *Kalb v. Feuerstein*, 308 U.S. 433; and the *Emergency Price Control Act*, 56 Stat. 23, 50 U.S.C. App. Supp. II, Section 901; *Bowles v. Willingham*, 321 U.S. 503.

⁵Sec. 12 of the Act of March 2, 1793, 1 Stat. at L. 73, 79.

Apart from statutory exceptions during the sixty-three year period from the revision of 1878 until the decision in *Toucey v. New York L. Ins. Co.*, 314 U.S. 118, the Supreme Court has passed upon the statutory restriction of the Judicial Code, Section 265, in some sixty-two cases, in the course of which certain apparent judicial exceptions were engrafted on that section.

In *res* cases, a federal court first acquiring jurisdiction of the *res* was permitted to protect its jurisdiction by restraining state court proceedings seeking to interfere therewith despite the prohibitions of Sec. 265. *Julian v. Central Trust Co.*, 193 U.S. 93; *Mandeville v. Canterbury*, 318 U.S. 47.

This apparent exception is based upon one of two theories. *Essanay Film Mfg. Co. v. Kane*, 258 U.S. 358, places it on the ground that the exception actually constitutes a compliance with the Code restriction, that is, it prevents friction between the federal and state court systems by eliminating simultaneous litigation by courts of both systems over the same subject matter.

“... In exceptional instances the letter (of the Judicial Code, Sec. 265) has been departed from while the spirit of the prohibition has been observed; for example, in cases holding that, in order to maintain the jurisdiction of a Federal court, properly invoked, and render its judgments and decrees effectual, proceedings in a state court which would defeat or impair such jurisdiction may be enjoined. . . . The effect of this, as will be observed, is but to enforce the same freedom from interference, on the one hand, that is the

prime object of Sec. 265 to require, on the other. 258 U.S. 358, 361" (parentheses added).

A second basis of justification of this apparent exception rests upon Section 262 of the Judicial Code (28 U.S.C. 377) giving the federal courts power to issue all writs necessary for the exercise of their jurisdiction. In *Kline v. Burke Constr. Co.*, 260 U.S. 226, it was claimed that the use of injunction in these cases merely protected the jurisdiction of the federal courts.

A second apparent exception was had where a federal injunction was invoked to stay the enforcement of fraudulent state court judgments. *Simon v. Southern R. Co.*, 236 U.S. 115.

A question exists whether this rests on the theory that invalid state court proceedings are not statutory state court proceedings within the meaning of Section 265 of the Judicial Code, or whether this is a judicially legislated exception to that section. *Hill v. Martin*, 296 U.S. 393.

A third apparent exception, developed by the courts in relitigation cases (*Prout v. Starr*, 188 U.S. 537; *Julian v. Central Trust Co.*, 193 U.S. 93), was repudiated by a majority of the court in *Toucey v. New York L. Ins. Co.*, 314 U.S. 118, and *Southern Railway Co. v. Painter*, 314 U.S. 155, although subsequently restored as a legislative exception by the 1948 revision of the Judicial Code, 28 U.S.C. 2283.

The process of judicially engrafting exceptions to the prohibition of the Judicial Code, Section 265, was

brusquely checked by the Supreme Court in *Toucey v. New York L. Ins. Co.*, *supra*. The question for consideration was whether a federal court could stay proceedings in a state court, the claim pressed therein having previously been decided adversely to the claimant in the federal court.

Mr. Justice Frankfurter, writing the opinion for the court, points out that a judicial exception was engrafted to the Act of 1793 in *res* cases, which exception was not only compatible with the principles and philosophy of the statutory restriction, but was firmly established and recognized by Congress when the Judicial Codes were revised. In relitigation cases, on the other hand, no such exception had been firmly established or recognized by Congress and should not be judicially recognized, such exception being violative of the Judicial Code, Section 265.

The tone and temper of the opinion is critical of attempts by federal courts to judicially legislate exceptions to the statutory restrictions.

“We find, therefore, that apart from congressional authorization, only one ‘exception’ has been embodied in Sec. 265 by judicial construction, to wit, the *res* cases. The fact that one exception has found its way into Sec. 265 is no justification for making another.” (314 U.S. 118, 139.)

The opinion concludes:

“... We must be scrupulous in our regard for the limits within which Congress has confined the authority of the courts of its own creation.” (314 U.S. 118, 141.)

Since the *Toucey* case, *supra*, Congress has created additional exceptions by virtue of the *Emergency Price Control Act*, 56 Stat. 23, and by the 1948 revision of the Judicial Code (Act of June 25, 1948, c. 646, 62 Stat. 869).

By revision in 1948, Section 2283, 28 U.S.C. now provides:

“A court of the United States may not grant an injunction to stay proceedings in a State Court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction or to protect or effectuate its judgments.”

While the statutory revision does create an exception in relitigation cases denied as a matter of judicial interpretation of Section 265, Judicial Code, in the *Toucey* case, *supra*, and while it may restore “the basic law as generally understood and interpreted prior to the *Toucey* decision” (Revisers’ Notes to 28 U.S.C. p. 1910, Section 2283; *First Nat. Bank & Trust Co. of Racine v. Village of Skokie*, C. A. 7, 173 F. (2d) 1), Congress has the power to restrict the exercise of jurisdiction by the lower federal courts as was stated in *Lockerty v. Phillips*, 319 U.S. 182, 187:

“The Congressional power to ordain and establish inferior courts includes the power ‘of investing them with jurisdiction either limited, concurrent, or exclusive, and of withholding jurisdiction from them in the exact degrees and character which to Congress may seem proper for the public good.’ *Cary v. Curtis*, 3 How. (U.S.) 236, 245, 11 L.Ed. 576, 581, . . .”

The principle of the *Toucey* case, *supra*, that the courts of the United States may not carve judicial exceptions out of restrictions congressionally imposed is still sound law controlling upon this court as well as upon the trial court and on other federal courts. A federal court may not stay state court proceedings where not authorized so to do by Congress either by 28 U.S.C. Section 2283 or by other specific federal legislation.

D. Legislative restriction on federal courts staying state court proceedings as a limitation upon jurisdiction or equity powers.

Prior to *Smith v. Apple*, 264 U.S. 274, it was implicit in the supreme court decisions that the restrictive provision of Judicial Code Section 265 constituted a limitation on the jurisdiction of the federal courts. In *Diggs & Keith v. Wolcott*, 4 Cranch 179, it was expressly so held, and this holding was repeated in unmistakable language in *Ex parte Sawyer*, 124 U.S. 200, *Harkrader v. Wadley*, 172 U.S. 148, and *Ex parte Young*, 209 U.S. 123.

The question of *Smith v. Apple*, 264 U.S. 274, was whether an appeal from the refusal of a federal district court to enjoin a proceeding in a state court under Judicial Code Section 265 constituted an issue as to "the jurisdiction of the court", under the appeal statutes. The Supreme Court found it had no jurisdiction of the appeal, stating with respect to Section 265 (264 U.S. 274, 278-280):

" . . . It is not a jurisdictional statute. It neither confers jurisdiction upon the district

courts nor takes away the jurisdiction otherwise specifically conferred upon them by the Federal statutes. It merely limits their general equity powers in respect to the granting of a particular form of equitable relief, that is, it prevents them from granting relief by way of injunction in the cases included within its inhibitions. In short, it goes merely to the question of equity in the particular bill. . . . This section, as settled by repeated decisions of this court, does not prohibit in all cases injunctions staying proceedings in a state court. Such injunctions may be granted, consistently with its provisions, in several classes of cases. . . . Necessarily, therefore, in a suit in equity of which a district court has jurisdiction under the Federal statutes, where the relief sought is an injunction against proceedings in a state court, it is the duty of the court to determine, under the allegations and proof, whether a case is made which entitles the plaintiff to the injunction sought; that is, whether the case presented is one in which such relief is prohibited by the statute, or one in which it may nevertheless be granted. . . . Where the plaintiff has the undoubted right to invoke its Federal jurisdiction, the court is bound to take the case and proceed to judgment. . . . And when the court takes jurisdiction and determines that, in the light of Sec. 265 of the Code, it is either authorized or prevented from granting the injunction prayed, its decision, whether the relief sought be granted or denied, is plainly not a decision upon a jurisdictional issue, but upon the question whether there is or is not equity in the particular bill, that is, a decision going to the merits of the controversy.”

This interpretation that the restrictive provisions of Judicial Code Section 265 constitute limitations on general equity powers of federal courts rather than limitations of jurisdiction has been repeated in *Treinies v. Sunshine Min. Co.*, 308 U.S. 66, 74. The Supreme Court has never considered however that this limitation is such as can be waived by a federal court in its discretion upon finding a jurisdictional basis for the granting of the relief sought. At all times, the Supreme Court has held this limitation is an effective one barring relief calling for a stay of a state court proceeding. In other words, whether this limitation is upon jurisdiction or upon the equity powers of the court, the end result is the same and no injunction can be granted unless the case falls within an exception to the prohibition of Section 265. In *Hill v. Martin*, 296 U.S. 393, 403, Mr. Justice Brandeis, having previously cited *Smith v. Apple*, *supra*, points out:

“... the prohibition (of Sec. 265) applies whatever the nature of the proceeding, (in the state court) unless the case presents facts which bring it within one of the recognized exceptions to Section 265.” (Parentheses added.)

In the *Toucey* case, the Court quotes from *Smith v. Apple* (314 U.S. 118, 130 n. 2) and thereafter sanctions federal court intervention staying state court proceedings only in those cases falling within the statutory exceptions to Section 265 and in the *res* cases.

If the injunctive relief prayed for in the federal court calls for a stay of a state court proceeding, and the case does not fall within a statutory exception, or is not a *res* case, then Section 265, irrespective of any equities raised by the case, constitutes an effective restriction against the issuance of such a stay. To hold otherwise would permit a federal court to stay state court proceedings whenever the equities presented were strong, and thus exception upon exception to the statutory prohibition would be created.

Contrary to these decisions, the court below proceeded on the theory that the statutory restriction being, not upon the jurisdiction of the court, but upon the exercise of equitable powers, the restriction had no greater effect than the basic limitation against the granting of equitable relief in cases where an adequate remedy exists at law, the determination of the adequacy of the legal relief being for the equity court. The approach of the trial court is that the matter falls purely within its discretion and the weight of the equities may overbalance the restrictive provisions of the section and permit the court, in consequence, to stay court proceedings in other than the federal courts. Having jurisdiction under the Civil Rights Acts, the court feels it may exercise jurisdiction and protect it by staying the proceedings in the territorial courts, provided the factual basis for equitable relief exists. The restrictions of Section 265 go merely to the question whether the court should exercise its equity powers (R. 469).

Reliance is placed by the court on the case of *Keegan v. State of New Jersey*, 42 F. Supp. 922, 924.

enforcement of the statute may result in the deprivation of civil rights provided by federal statute or the Constitution of the United States does not alter this rule. That the prosecution involves exceptional circumstances and will result in a great and immediate danger of irreparable loss does not alter this rule. A combination of these factors does not alter this rule.

Except where Congress has expressly permitted federal courts to enjoin proceedings in state courts, they may not do so.

Since, however, there are no restrictions upon a federal court staying enforcement proceedings under a state criminal statute, prior to the time that the enforcement procedure has advanced to the stage of becoming "proceedings in a court of a state", assuming, always, the proper federal jurisdictional basis is had and the case presents the requisite "exceptional circumstances", injunctions have been permitted to be issued out of United States courts to stay the enforcement of threatened prosecutions of allegedly unconstitutional state criminal statutes. The distinction is between "threatened" criminal prosecutions, which may under proper circumstances be enjoined by federal courts, and "pending" criminal prosecutions, which may be enjoined, only where specifically so provided by federal statute.

Parkersburg & O. River Transp. Co. v. Parkersburg, 107 U.S. 691, is the first case in which the Supreme Court made this distinction. The Transportation Company filed a bill in the federal courts in

West Virginia to restrain proceedings commenced in the state courts by the City of Parkersburg for the collection of wharfage. It was claimed by the Transportation Company that the ordinance under which the City was proceeding was unconstitutional. In its opinion, the court passed on Section 720 of the Revised Statutes (later Section 265 of the Judicial Code) and states:

“If the 720th section of the Revised Statutes, which declares that ‘The writ of injunction shall not be granted by any court of the United States to stay proceedings in any court of a State,’ applies to suits originally brought in the circuit courts by virtue of the Act of March 3, 1875 (18 Stat. at L., 470), in cases arising under the Constitution or laws of the United States, it is clear that so much of the bill in this case as prays for an injunction to restrain legal proceedings already instituted before the recorder of Parkersburg before it was filed, cannot be maintained. But that portion of the bill which seeks to have the wharfage ordinance declared void, and to restrain any further collections under it, and any further interference with the right of the complainant to the free navigation of the Ohio River, is not open to this objection, . . .”

Parkersburg & River Transp. Co. v. Parkersburg, 107 U.S. 691, 711.

In *Ex parte Young*, 209 U.S. 123, the Supreme Court did not pass upon the statutory restriction as such, but considered the general problem of federal courts enjoining state court proceedings, and arrived at the same result.

“It is further objected (and the objection really forms part of the contention that the state cannot be sued) that a court of equity has no jurisdiction to enjoin criminal proceedings by indictment or otherwise, under the state law. This, as a general rule, is true but there are exceptions. when such indictment or proceeding is brought to enforce an alleged unconstitutional statute, which is the subject-matter of inquiry in a suit already pending in a Federal court, the latter court, having first obtained jurisdiction over the subject-matter, has the right, in both civil and criminal cases, to hold and maintain such jurisdiction, to the exclusion of all other courts, until its duty is fully performed . . . But the Federal court cannot, of course, interfere in a case where the proceedings were already pending in a state court.”

Ex parte Young, 209 U.S. 123, 161-162.

The leading case on the subject is *Cline v. Frink Dairy Co.*, 274 U.S. 445. A prosecution was commenced and others threatened for violations of state and anti-trust law. An injunction against the prosecutions was sought in the federal courts on the ground that the statute was unconstitutional. The three-judge district court entered a permanent injunction. A dissent was filed, in which it was contended that the threatened actions could be restrained, but the pending actions in the state court could not be enjoined because of the restrictive provisions of the federal statute, 9 F. (2d) 176, 182. The Supreme Court states very tersely on this point, 274 U.S. 445, 452-453:

“It is objected, however, that the injunction can not be supported under the authorities, in so far

as it is directed against actual proceedings pending in criminal court. One of the district judges below dissented from this part of the decree. Of course, the injunction is not only against a multiplicity of future suits and the threatened proceedings for forfeiture, by which the attorney general proposes to end the businesses of all the plaintiffs, and the objection would only lead to a narrowing of the decree. . . .

“ ‘. . . But the Federal Court can not, of course, interfere in a case where the proceedings were already pending in a state court. *Taylor v. Taintor*, 16 Wall. 366, 370, 21 L. ed. 287, 290; *Harkrader v. Wadley*, 172 U.S. 148, 43 L. ed. 399, 19 Sup. Ct. Rep. 119.’

“We therefore agree with the view of the dissenting judge that the injunction is too broad, in so far as it restrains proceedings actually pending, and that it must be accordingly modified.”

The rule of the *Cline* case has been recognized and followed by this court in *Babcock v. Noh*, 99 F. (2d) 738, as well as by the Eighth Circuit in *Smith v. Dudley*, 89 F. (2d) 453, by a three-judge district court in *Society of Good Neighbors v. Groat*, 77 F. Supp. 695, and by single district court judges in *Mickey v. Kansas City, Mo.*, 43 F. Supp. 739, and *Priceman v. Dewey*, 81 F. Supp. 557. This rule is based on logic and common sense. An injunction against a threatened prosecution does not stay a proceeding in a state court but *in limine* prevents such proceeding from getting into the state court. A pending proceeding, to the contrary, is clearly a proscribed “proceeding in a state

court", the stay of which by a federal court is prohibited.

A. F. of L. v. Watson, 327 U.S. 582, is not contrary. The State Attorney General, according to the petitioner's pleading, had instituted quo warranto proceedings against employers who had closed shop contracts with the petitioning union, to enforce provisions of the state constitution prohibiting discrimination against employees because of membership or non-membership in labor unions. The threat of a multiplicity of actions was also alleged. The three-judge district court dissolved the temporary injunction on grounds other than the application of Section 265 of the Judicial Code to pending criminal prosecutions. The point was apparently not raised and was not discussed by either the trial court or the Supreme Court. The pending, as opposed to the threatened prosecutions were relatively few and insignificant. The general enforcement of the constitutional provision was the matter of prime concern, both to the state and to the union. The case did not pass upon the question of the propriety of a United States court enjoining pending criminal proceedings in a state court and therefore did not in any way modify the ruling previously enunciated in the *Cline* case.

In every case, therefore, in which the issue has been squarely raised, the courts have held that the federal courts may not stay pending criminal proceedings due to the prohibitions contained in Section 265 of the old Judicial Code (now Section 2283 of Title 28 U.S.C.).

The fact that rights arising under the Civil Rights Act may be involved and jeopardized in the pending criminal prosecutions does not of course alter the principle or its application. Neither the Civil Rights Act nor Section 265 of the old Judicial Code provided any exceptions in Civil Rights cases to the restriction against federal courts staying pending proceedings in state courts.

On many occasions this court and other federal courts have recognized the applicability of Section 265 to Civil Rights cases and have refused to grant relief which would require staying state court proceedings. *Aultman & Taylor Co. v. Brumfield*, 102 Fed. 7, appeal dismissed, 22 Sup. Ct. 938, 46 L. ed. 1265; *Mickey v. Kansas City, Mo.*, 43 F. Supp. 739; *Atlantic Fisherman's Union v. Barnes*, 71 F. Supp. 957; *Babcock v. Noh*, 99 F. (2d) 738; *Society of Good Neighbors v. Groat*, 77 F. Supp. 695.

The present Section 2283 of Title 28 permits United States courts to grant injunctions to stay state court proceedings only where authorized by Congress, where necessary in aid of jurisdiction, or to protect or effectuate judgments. Civil Rights cases fall into none of these categories. They are not exempted by Act of Congress from the limitations of Section 2283. Section 2283 itself does not provide for injunctions in such cases. Since pending criminal proceedings necessarily antedate federal action, there is no question of preserving the jurisdiction of federal courts, the matter first having come within the jurisdiction of the state court.

Similarly there is no question of protecting or effectuating a judgment of the federal court, there being no federal court judgment to be protected or effectuated when the stay is sought in the federal court against the continuance of the pending state court criminal proceedings.

As Section 2283 does not provide for stays against state court proceedings in Civil Rights cases, and as no other federal act makes any exceptions to the prohibitions of Section 2283 in these cases, an injunction cannot be granted, the federal courts being without power to make any further exceptions to the restrictions of that section. *Toucey v. New York L. Ins. Co.*, *supra*.

F. Application of Section 2283 to the courts of the Territory of Hawaii.

Section 2283 of Title 28 is a limiting provision on the federal courts in their relationship with state courts. Neither in 2283, nor in the acts from which it has been derived, is mention made of any courts other than state courts as coming within the protective provisions of freedom from intervention by the federal courts. It is extremely doubtful whether the word "state" as used in this and predecessor enactments includes within its scope "territories".

The legislative history of the initial enactment in 1793 (Act of March 2, 1793, Ch. 22, Sec. 5, 1 Stat. 334) is shrouded in darkness, no record of any debates on the Act being extant, and the theories of its enactment being diverse, *Toucey v. New York L. Ins.*

Co., 314 U.S. 118, 131; Warren, *Federal and State Court Intervention*, 43 Harvard Law Review, 345.

While on occasion "state" in federal statutes has been held broad enough to encompass territories, *Talbott v. Silver Bow County Comrs.*, 139 U.S. 438, in the absence of a clear legislative intent that territories shall have this coverage, it has generally been narrowly confined, *Downes v. Bidwell*, 182 U.S. 244; *Territory of Alaska v. Troy*, 258 U.S. 101; *Stainback v. Mo Hock Ke Lok Po*, 336 U.S. 368.

While no definitive judicial determination has been given of the meaning of the word "state" in Section 2283 or predecessor enactments, it is significant that the judiciary act of 1789, to which the original act of 1793 is amendatory, has been interpreted by the Supreme Court, which has held that the provisions dealing with the selection of juries, applies only to states and not territories, *Clinton v. Englebrecht*, 13 Wall. 434. Likewise under the same act it was held that a citizen of the Territory of Mississippi was not a citizen of a state within the diversity of citizenship provisions, *New Orleans v. Winter*, 1 Wheat. 91, following Chief Justice Marshall's opinion in *Hepburn v. Ellzey*, 2 Cranch 445, "that the members of the American Confederacy are only the states contemplated in the Constitution". If, following Marshall, "state" is used in the judiciary act as the term is used in the Constitution, then logically it should have the same meaning in this enactment supplementing the judiciary act. As such, territories would not come within its purview.

The care with which the words "state" and "territory" are used in the Judicial Code adopted in 1911 (Act of March 3, 1911, 36 Stat. 1087, et seq.) and particularly Section 249 thereof, providing that writs of error and appeals should not be affected by the admission of any "territory" as a "state" after judgment or decree (with an eye particularly to Arizona and New Mexico, and then admitted as states), further indicates that "state" as used in Section 379 of Tit. 28, U.S.C., is not intended to include territories.

The similar nice use of the word "territories" in various sections of the Revision of 1948 (e.g., the inclusion of citizenship in territories as a basis for diversity of citizenship for jurisdiction in the federal courts, Section 1332), shows a clear legislative intent that "states", were not otherwise qualified, should not include territories. See also Section 1738 and *Stainback v. Mo Hock Ke Lok Po, supra*, holding "state" in Section 2281 and 2284 does not include territories.

But apart from the language of the Judicial Code, which does not prohibit federal courts from staying proceedings in territorial courts as it does in state court proceedings, the courts of the Territory of Hawaii have, by virtue of the Organic Act of the Territory, been placed in the same position as state courts in relation to the federal court system, and consequently, while the provisions of Section 2283 are not *per se* applicable to territorial courts, that section, taken with the provisions of the Organic Act, require that the restriction on federal courts enjoining non-federal court proceedings include within its protec-

tion, the courts of the Territory of Hawaii. This analogous position of the courts of the Territory of Hawaii and the courts of the various states with relation to the federal court system has been recognized by this Court in the recent case of *Alesna v. Rice*, 172 F. (2d) 176, 179, and on many occasions by the United States Supreme Court, *Equitable L. Assur. Co. v. Brown*, 187 U.S. 308; *Ex parte Wilder Steamship Co.*, 183 U.S. 545; *Wilder's S. Co. v. Hind*, 108 Fed. 113.

The recognition by Congress of the organized state of the judiciary in the then Republic of Hawaii,⁶ and its intent to preserve that system and to coordinate it with the federal judicial system in the same relationship as existed between the courts of the various states and the courts of the United States, is evident by the language of the Organic Act itself. Section 86(d) (48 U.S.C. Section 645) provides *inter alia*:

“... The laws of the United States relating to appeals, removal of causes, and other matters and proceedings as between the courts of the United States and the courts of the several States shall govern in such matters and proceedings as between the courts of the United States and the courts of the Territory of Hawaii. . . .”

⁶The Committee on Territories of the House of Representatives, upon receipt of a report from the Judiciary Committee of the Hawaiian Commission, in which the then existing Judiciary of the Republic of Hawaii was described, reported: “In view of the foregoing report it must be considered wise and safe to provide for the organization of the Territorial Courts of the Territory of Hawaii by substantially continuing them as now existing under the Republic of Hawaii and this has been done in the present bill.” Report on H.R. 2972 from Committee on Territories, 56 Cong., 1st Sess., Report No. 305.

It is to be observed that the Organic Act as originally enacted, not only created the aforementioned relationship between the United States courts and the territorial courts, but the recognition of the territorial court system as one completely independent of the lower federal courts and completely analogous to the state court systems, is clear from the fact that, unlike any other territory of the United States, cases could be taken from the territorial Supreme Court, as from the highest court of a state, to the Supreme Court of the United States, only by writ of error, and only when a federal question was involved. No appeals such as could be had from the highest court of other territories could be had either in the United States Supreme Court or to any other federal court.

It was not until the Territory was five years old that any changes were made in this appellate procedure. In 1905, the appeal provisions were amended (33 Stat. Ch. 1465, Section 3), to permit appeals as well as writs of error to the United States Supreme Court in cases involving \$5,000.00 or more, as well as in cases regarding federal questions.

These amendatory provisions were incorporated in Section 246 of the Judicial Code of 1911 (36 Stat. 1158), which declared that the appellate procedure to be followed in the United States Supreme Court from final judgments and decrees of the territorial Supreme Court should be prosecuted "within the same time, in the same manner, under the same regulations, and in the same classes of cases in which writs of error and appeals from the final judgments and de-

crees of the highest court of a state in which his decision in the suit could be had . . .”

These provisions were retained in the amendment of 1915 (38 Stat. 804), which added provisions for taking cases from the territorial to the federal Supreme Court by *certiorari* and from the territorial Supreme Court to the Circuit Court of Appeals by appeal and error where the amount involved was \$5,000.00 or over.

It was not until 1925 that the immediate appellate relationship between the territorial and United States Supreme Courts, permitting direct review by the latter over the decrees and decisions of the territorial Supreme Court, was terminated (Act of February 12, 1925, Ch. 220, 43 Stat. 890).

At the time of annexation, Congress found an independent organized judicial system in the Republic of Hawaii, and provided for its maintenance in a manner completely analogous in all respects to state court systems. In this regard the Territory of Hawaii was unique among territories upon annexation to the United States. The relationship of its courts to federal courts was at that time identical to the relationship between state and federal courts.

There can be no serious question but that in 1911, when the Judicial Code was revised, Section 265 thereof, prohibiting federal courts from issuing stays against proceedings in state courts, was to be read in connection with Section 246 of the Judicial Code dealing with the direct review by the United States Su-

preme Court of territorial court decrees and decisions in other cases where similar review could be had of the highest courts of the states, and in addition Section 265 of the Judicial Code was to be read in connection with the provisions of the Organic Act requiring the application of the laws of the United States relating to matters and proceedings between the courts of the United States and the courts of the several states as governing between the courts of the United States and the courts of the Territory of Hawaii.

Since that time, there has been no modification of the provision of the aforementioned provision of the Organic Act, and the same construction must be given to Section 2283. That section, taken with the Organic Act, clearly protects territorial courts as state courts are protected from federal court intervention in federal cases.

The several states of the union, in the exercise of their governmental functions, are protected against interference by federal courts in two respects: (1) The courts of the states are free to hear pending cases before them without interference by the courts of the United States; (2) where federal judicial interference is permissible to stay the enforcement of state statutes, such interference can only be had upon consideration by a federal district court composed of three judges (28 U.S.C. Sections 2281 and 2284). This latter provision was in its original form (Judicial Code of 1911, Section 266) passed by Congress to correct the abuses found to be existent in the inter-

vention and interference with the enforcement, operation and execution of state statutes by hasty or improvident action of a single federal court judge.⁷

Both of these preventive provisions against interference by federal courts in state activities, basic minimal essentials for the protection of states, have been found absolutely necessary for the preservation of the independence of the sovereign states and for the minimizing of friction between the state and federal court systems.

By the *Stainback* case, it has been held that the three-judge district court provisions now contained in Sections 2281 and 2284 are not applicable to the Territory of Hawaii because the wording of the statute does not permit of coverage of territories along with states, because the statute imposes a burden on the federal judiciary both at the levels of circuit courts and of the Supreme Court and is, consequently, to be narrowly construed and its provisions strictly confined, and because the Territory of Hawaii does not have the sovereignty of a state and is subject to direct legislative control by the Congress of the United States. The result of this decision is to place the

⁷The abuses in the intervention by federal courts to stay the enforcement of state statutes became of such concern to Congress that in 1910 an amendment to the Judicial Code was adopted by the House of Representatives to take from federal district courts jurisdiction of suits "to suspend, enjoin or restrain the action of any official of a state, upon the ground of the unconstitutionality of such statute" (46 Cong. R. 313 (1910)). It failed to pass the Congress. However, in the same year, by amendment to the Mann-Elkins Act, three judges were required to sit in a suit praying for an interlocutory injunction to stay the enforcement of state statutes (Act of June 18, 1910, Sec. 17, 36 Stat. 539, 557).

Territory of Hawaii in a position where it may be subjected to the abuses Congress found to exist at the time of the enactment of the three-judge court provision in the Judicial Code.

Having so exposed the Territory to the possible hasty or improvident action of a single federal court judge upon the constitutionality of a territorial statute, it is imperative that the Territory and its courts be given that protection afforded to the states, in prohibiting such a single judge from interfering with pending cases in territorial courts. In other words, if it is felt necessary that a three-judge federal court should be prohibited from staying proceedings in a state court, *a fortiori* a single judge sitting in the district court, susceptible to improvident or hasty action, should be prohibited from staying proceedings in a territorial court. Stripped of both of these protections, the territorial courts would necessarily lose their independence and integrity and would become merely adjuncts of the federal court system. This certainly was never intended by Congress, and the result should not be attempted by judicial construction.

The protective provision of Section 2283 does not rest upon sovereignty. It is not concerned with any federal legislative control that may be had over the jurisdiction in which the court sits. It rests solely upon the protection any judicial system requires for its existence.

This was recognized by the Supreme Court in the early case of *Peck v. Jenness*, 7 How. 612, where Mr.

Justice Grier traces the rule of comity between court systems, codified into a rule of positive law by the Act of 1793, back to the case of *Kennedy v. Earl of Cassilis*, 2 Swanst. 313, wherein Lord Eldon reversed himself and dissolved an injunction to restrain proceedings in a Scottish court. Such comity between court systems, even apart from statutes, is absolutely essential to maintain the independence of each and to prevent friction between them, *Western Fruit Growers v. U. S.*, C.C.A. 9, 124 F. (2d) 381.

It is therefore submitted that by juxtaposition of Section 2283 and Section 86(d) of the Organic Act, the prohibition against federal court intervention by stay in state court proceedings is to be extended to similarly protect pending proceedings in the courts of the Territory of Hawaii, that in all respects Section 2283 is equally applicable to the courts of the Territory of Hawaii and to the several states, and that the federal courts may not intervene in any territorial court proceedings. As a consequence, the trial court, in assuming the power to stay proceedings in the territorial circuit courts and proceedings before the Grand Jury of the County of Maui, committed reversible error. It is therefore submitted that this Court should remand the cases to the United States District Court for the District of Hawaii for the dissolution of the stays previously issued, and for the dismissal of the actions.

II.

CRITICISM OF THE COURTS AND LACK OF SUPPORT IN THE
RECORD OR IN FACT OF ANY INFERENCE THAT THE
TERRITORIAL JUDICIAL SYSTEM IS NOT ADEQUATE TO
AFFORD FULL REDRESS FOR ANY DEPRIVATION OF
RIGHTS.

Because of the peculiarly defenseless position of judges when subjected to attack, it is deemed to be the responsibility of The Bar Association of Hawaii, in compliance with the precepts of the *Canons of Professional Ethics*, to support the judges of the Territory of Hawaii against any improper criticism of them that may either advertently or inadvertently have crept into the decision of the court below. To that end, this section of the brief will be devoted, to an analysis of those portions of the opinion of the trial court which might be regarded as being unfairly critical of the judges of the territorial courts, and to clarify the record in this respect.

This portion of the brief is not directed to any criticisms that may have been made of the prosecuting officers of the Territory of Hawaii, except to the extent that such criticism might be so intrinsically connected with that of the courts that they must be considered as an integral whole.

A. The approval by the territorial courts of private counsel acting as prosecuting officers, particularly in labor cases.

In its analysis of the 1924 strike of the Filipino laborers and the riot in which four policemen and sixteen laborers were killed, and the ensuing prosecution under the territorial *Unlawful Assembly & Riot*

Act, the trial court purports to take judicial notice of the "arcing of law enforcement from the regularly constituted territorial authorities to prosecuting attorneys employed . . . by the planters", the approval of these practices by the territorial courts, and the fact that the practice of private prosecutors representing the Territory has occurred most frequently in criminal cases growing out of labor disputes (R. 388-389).

There is nothing in the record before this Court dealing with the Filipino strike which occurred twenty-five years ago. The finding of the court below must rest, as the opinion has indicated, only upon judicial notice.

The inference that might be drawn from the cited passages of the opinion is that in the Territory of Hawaii the criminal law has been, and is being, administered for the private ends of the plantations through the conduct of the prosecution of criminal cases in which the plantations are complainants, by private counsel, and that all of this has occurred with the approval of the territorial courts.

There is no evidence in the record to support this conclusion. It is not justifiable on any basis of judicial notice, because it is submitted that such facts are neither notorious nor existent.

This Court will notice that, of the three judges sitting in the court below, only one is a resident of Hawaii. The other two judges have very limited personal knowledge on the subject of the conduct of trials in the territorial courts. The method by which they

were informed as to the practices of those courts does not appear in the record before this Court. To the contrary, the record before this Court shows that in all of the prosecutions in the territorial courts which were sought to be enjoined in this action, or which were related to this action, prosecutions were conducted solely by government counsel.

Those matters of which judicial notice may be taken, must of necessity be matters of common or general knowledge, well and authoritatively settled, and not doubtful or uncertain, *Werk v. Parker*, 249 U.S. 130; *Waters-Pierce Oil Co. v. Deselms*, 212 U.S. 159; *Dominion Hotel v. Arizona*, 249 U.S. 265. The facts herein referred to, of which the court below took judicial notice, do not comply with this standard in any respect. Certainly the record in this case and the history of the Courts of the Territory of Hawaii do not justify the conclusion that the territorial courts approved any "arcing of law enforcement from the regularly constituted territorial authorities to prosecuting attorneys employed . . . by the planters."

The matter of private counsel prosecuting criminal cases was first directly brought to the attention of the Supreme Court in the case of *Woodward v. Republic of Hawaii* (1896), 10 Haw. 416, a seduction case. It was contended that the case was not prosecuted by the authority of the Republic, being prosecuted by private counsel, and it not appearing of record that the prosecution was authorized by the Attorney General. Under the facts the Court presumed the Attorney General's authorization.

A more complete consideration of the question was had in *Territory of Hawaii v. Chong Chak Lai*, 19 Haw. 437, a case in which counsel for the Chinese Consul, the prosecuting witness, appeared as associate counsel in the prosecution. In construing the statute relating to the duties of the Attorney General and the rights of private attorneys,⁸ the court, after reviewing cases in other jurisdictions, found that the territorial statutes permitted private counsel to appear as assistant counsel for the prosecution. The court states with respect thereto:

“... The attorney general and his deputies are required to appear for the Territory in all public prosecutions and are responsible on their oaths of office for the performance of their duties without fee or reward. They cannot delegate the performance to private persons nor is this done by permitting an attorney employed by private persons to assist in trials. The attorney general does not thus relinquish his control over a case. It would be the duty of the court to restrain any exhibition of spite or any attempt at persecution on the part of counsel so engaged. The public conscience would quickly be aroused by any appearance of administering the criminal law for merely private ends.”

⁸Sec. 1551, Revised Laws of Hawaii, 1905: “He (the Attorney General) shall not receive any fee or reward from or in behalf of any person or prosecutor, for services rendered in any prosecution . . . to which it shall be his official duty to attend; . . .” (parentheses added) (presently contained in Revised Laws of Hawaii, 1945, Sec. 1506). Sec. 1700, Revised Laws of Hawaii, 1905, provides that attorneys shall have the right to practice in all courts of the Territory “for the prosecution or defense of actions, civil, criminal or mixed . . .” (now contained in Sec. 9708, Revised Laws of Hawaii, 1945). Also considered was Sec. 1546, Revised Laws of Hawaii, 1905 (now 1501, Revised Laws of Hawaii, 1945).

The cases of *Territory of Hawaii v. Robello*, 20 Haw. 7, and *Territory of Hawaii v. Soga*, 20 Haw. 71, also touch upon this problem.

Thus, the territorial courts have approved participation by private counsel in the prosecution of criminal cases, only where the proper prosecuting officers do not relinquish control of the case. This view appears to have been adopted by the majority of the American jurisdictions, *Ates v. State*, 141 Fla. 502, 194 So. 286, *People v. Lee*, 368 Ill. 410, 14 N.E. (2d) 498, as well as having been recognized as a proper principle by the federal courts, *Krotkiewicz v. U. S.*, 19 F. (2d) 421, C.C.A. 6. It is regarded as improper, of course, for the prosecuting officers to be superseded by private counsel and for the control of the case to pass out of the hands of government attorneys, *Perry v. State*, Okla., 181 P. (2d) 280, a view consistent with that expressed by the territorial Supreme Court in the *Chong Chak Lai* case.

There is nothing appearing in the record of the instant case to indicate that in any of the prosecutions referred to, or in any case in the Territory of Hawaii in which private counsel have associated in the prosecution, the Attorney General or other prosecuting officer has in dereliction of his responsibilities abdicated and turned the control of the case over to private counsel. There is certainly nothing in the record of this case or in the records of the territorial courts to indicate that if such had occurred it would receive the approval of the courts. To the contrary, the Supreme

Court is on record with language which would disapprove such practice.

In passing, it should be observed that it has been further found by the court below, again based upon facts found to be "notorious" and thereby forming a basis for judicial notice of them, that the practice of private counsel prosecuting criminal cases has occurred most frequently in cases growing out of labor disputes. It is also intimated that this practice is one of frequent occurrence. Again no evidence supports this finding or conclusion, and it is submitted the facts in this respect are not only not notorious, but to the contrary appear to be non-existent. A review of the criminal cases in the territorial Supreme Court indicates that private counsel have not appeared for the Territory in the last fifteen years, and over a period of twenty-five years such appearances have occurred three times: *Territory v. Miyamoto*, 29 Haw. 685, involving a prosecution for embezzlement, *Territory v. Chun Yun*, 33 Haw. 109, a proceeding upon a bond to keep the peace; and *Territory v. Comacho*, 33 Haw. 628, a prosecution for criminal trespass. None of these cases was apparently connected with labor disputes.

It is therefore submitted that the Court's finding that there has been, with the approval of the territorial courts, an "arcing" of law enforcement from the territorial prosecuting authorities to plantation attorneys, is not founded upon any evidence in the record, does not have the requisite factual basis from which the court might make a finding based on judicial no-

tice, and to the contrary, is opposed to the facts as they exist in the courts of the Territory of Hawaii.

It is submitted that, in fairness to the courts of the Territory, the record should be corrected in this respect.

B. Criticism directed to the fixing of excessive bail.

In the course of its opinion, the court below found that the bail required of the defendants in certain territorial labor cases arising out of strikes was excessive. Standing alone, such a finding might not reasonably be regarded as a criticism of the territorial courts or any judge thereof. However, this finding is placed in a context which carries implications impugning the integrity of territorial courts.

The court below finds the excessive bail so fixed in these labor cases a "pertinent fact" which, taken with other facts, leads it to the conclusion that "the criminal proceedings complained of are being carried on for the purpose of an attack upon a labor movement rather than for the ends of justice" (R. 479-481).

The propriety of a federal court interfering in territorial court proceedings has previously been discussed. No consideration is to be given herein to the very important further question of the propriety or impropriety of a federal court reviewing in collateral proceedings the amount of bail set by a territorial judge.

This portion of the brief is directed solely to the question of the integrity of the judges of the courts of the Territory, and to any suggestions as might be con-

tained in the opinion of the court below that any judges of the territorial courts participated knowingly with or cooperated in any attempt to use the processes of law for other than the ends of justice. It is the contention herein advanced that any such charges are not supported by the record in this case.

Irrespective as to whether the bail fixed in the territorial courts was or was not excessive, it should be noted that the court below, in making its determination that the bail was excessive, did not apply the standard criteria used in such cases. The court was clearly influenced by its determination that the Territory of Hawaii is geographically isolated and that there is "but little chance for a defendant to escape" therefrom (R. 409-410).

It is to be observed that habeas corpus will not lie in the federal courts in a case where excessive bail has been set when the petitioner has actually posted the required bail, *Johnson v. Hoy*, 227 U.S. 245. Consequently a petition of habeas corpus would not have been had in the court below under the circumstances here existing. It should also be observed that the record shows no application by any of the defendants for reduction in bail either in the territorial courts or in the court below.

Any consideration of the question, therefore, constitutes a purely collateral review of the initial determination of the territorial court judge. The finding of the court below that the bail set in the territorial cases was excessive is purely gratuitous and apparently made solely for the purpose of establishing facts

justifying intervention by the federal court in territorial judicial proceedings.

Because the amount of the bail was not challenged in the territorial courts, but was posted on behalf of the individual defendants in those cases by the I.L.W.U., the court below has given no consideration to the ability of the individual defendants to make the required bail or to have the bail made for them. This is one of the most important factors to be considered by a court fixing the amount of bail and a court reviewing such determination. *Bennett v. U. S.*, 36 F. (2d) 475, C.C.A. 5.

While some consideration was indirectly given to the nature of the offense with which the individuals were charged, nothing was mentioned concerning the penalty for the offenses charged, the character and reputation of those accused, and the character and strength of the evidence against them, all factors obviously of great importance for a review in excessive bail cases. (72 A.L.R. 801, et seq., *Factors in Fixing Amount of Bail in Criminal Cases.*)

The chief emphasis in the finding that the bail is excessive rests on the isolation of the Territory of Hawaii. This finding is, of course, completely unrealistic in the middle of the Twentieth Century. With regularly scheduled airplanes, as well as those available for charter, flying between the Islands and the Mainland, any statement as to territorial isolation is slightly anachronistic. In less time than that required to go by train from Boston, Massachusetts, to Washington, D. C., or from Los Angeles to San Francisco,

passage can be had from Honolulu to the West Coast. Consequently, any statement that there is little chance for a defendant under bail to escape from the Territory of Hawaii because of geographic isolation is not to be given excessive weight.

The review by the court below of the fixing of bail by the territorial courts was irregularly undertaken, perfunctorily investigated, and then broadly condemned. The court below, with little actual knowledge of existing conditions in the Territory, without hesitancy and on the basis of an obvious misconception, substitutes its judgment on what should constitute a reasonable amount of bail in these cases, for that of the trial court. There is no evidence that factors considered by the trial court in determining its figures, which figures were not challenged in the territorial courts, were considered by the court below.

It is, therefore, submitted that in view of the suggestion by the court below that excessive bail so found by it was a factor leading to the conclusion that criminal proceedings in the territorial courts were being carried on for the purpose of an attack upon a labor movement, rather than for the ends of justice, this court should correct the record in this respect and, without conceding the validity of the suggestion of a dereliction of duty or venality of motive, that may or may not be attributable to the prosecuting authorities of the Territory of Hawaii, it should be found by this court that the record is bare of evidence of any misuse of the legal process by the judges and the courts of the Territory.

C. Other instances of apparent censure of the courts of the Territory of Hawaii.

Because of the serious suggestions made concerning the territorial courts in the two respects previously considered, other criticisms of the courts and judges contained in the opinion similarly denote that the court below may have imputed to them motives or conduct not in conformity with the high traditions of our judiciary. This is particularly so in view of the court's finding that the "*mores* of their (the Attorney General and Maui prosecutors) time and locality" have affected the motives of the Attorney General and prosecuting officers of Maui County in the performance of their duties and have led them to use the legislation under consideration as a club to beat labor.

In considering the proceedings on the challenges to Grand Jury in Criminal Numbers 2412 and 2413 before late Judge Albert M. Cristy,⁹ a criticism was directed toward Judge Cristy for permitting only a limited review of the methods of selection of the Grand Jury, the qualification of those members, and the Judge's basis for such limitations. In addition, the court below states:

" . . . Judge Cristy also excluded evidence which, from the nature of the offers made, would have tended to show more clearly that certain important elements of the community were precluded from serving on the Grand Juries of Maui

⁹This distinguished jurist died July 11, 1949, after a memorable judicial career, singularly marked by an unselfish devotion to the discharge of the duties of his office.

County. The Court, however, permitted enough evidence to come into the record to demonstrate the erroneous method employed in selecting the 1947 Maui County grand jury." (R. 498.)

and further stated:

"... The testimony received by Judge Cristy, however, makes it clear, ... that the exclusion of certain groups of the community was deliberate and intentional." (R. 503.)

If this language, in the light of the entire opinion, should be construed to mean that motives other than those which should properly inspire a trial judge in making his rulings governed Judge Cristy in the handling of this case, then, it is submitted that this language of the court below should be set aside and corrected. There is certainly nothing in the record that would justify any such conclusion, and the background and experience of this judge would refute any notion that he was motivated in any of his judicial actions by the so-called *mores* of the community to dispense other than absolute justice.

If the language previously quoted is not intended to convey any impressions critical of the integrity of Judge Cristy, then it is submitted that the ambiguity that presently exists in the language of the opinion of the court below should be clarified by this Court in the face of the clear record on the matter.

CONCLUSION.

The equitable power of the United States District Court for the Territory of Hawaii to stay criminal proceedings pending in the territorial courts has not been properly exercised in this case insofar as a basis for the exercise of such power is bottomed on the inadequacy of the territorial court system. Such foundation does not exist in fact or by reason of matters that can be judicially noticed.

The criticism of the judicial action implied in the opinion of the lower court is wholly unsupported by the record, and does not form an adequate basis for any finding or inference that the territorial judicial system is not adequate to afford full redress for any deprivation of rights.

Dated, January 25, 1950.

Respectfully submitted,

THE BAR ASSOCIATION OF HAWAII,

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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WALTER D. ACKERMAN, JR., individually and as
Attorney General of the Territory of Hawaii,
and JEAN LANE, individually and as Chief of
Police of the County of Maui,

Appellants,

vs.

INTERNATIONAL LONGSHOREMEN'S & WAREHOUSE-
MEN'S UNION, a Voluntary Unincorporated Asso-
ciation and Labor Union, et al.,

Appellees.

No. 12300

WALTER D. ACKERMAN, JR., individually and as
Attorney General of the Territory of Hawaii,

Appellant,

vs.

INTERNATIONAL LONGSHOREMEN'S & WAREHOUSE-
MEN'S UNION, a Voluntary Unincorporated Asso-
ciation and Labor Union, et al.,

Appellees.

No. 12301

Upon Appeal from the United States District Court
for the District of Hawaii, Sitting *En Banc*

APPELLEES' ANSWERING BRIEF

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APPELLEES' ANSWERING BRIEF

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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WALTER D. ACKERMAN, JR., individually and as
Attorney General of the Territory of Hawaii,
and JEAN LANE, individually and as Chief of
Police of the County of Maui,

Appellants,

vs.

INTERNATIONAL LONGSHOREMEN'S & WAREHOUSE-
MEN'S UNION, a Voluntary Unincorporated Asso-
ciation and Labor Union, et al.,

Appellees.

No. 12300

WALTER D. ACKERMAN, JR., individually and as
Attorney General of the Territory of Hawaii,

Appellant,

vs.

INTERNATIONAL LONGSHOREMEN'S & WAREHOUSE-
MEN'S UNION, a Voluntary Unincorporated Asso-
ciation and Labor Union, et al.,

Appellees.

No. 12301

APPELLEES' ANSWERING BRIEF¹

JURISDICTIONAL STATEMENT

These are appeals from a unanimous final decision² in these two cases of the United States District Court for the District of Hawaii, sitting *en banc*, composed of Senior United States Circuit Judge John Biggs, Jr., of the Third

¹ The amicus brief of the Bar Association of Hawaii supports the position of appellants on jurisdiction. Since the amicus brief raises no issues not raised by appellants, this answering brief is directed both to appellants' opening brief and the brief of the Bar Association.

² Opinion reported 82 F. Supp. 65, R. 366-520.

Judicial Circuit, Senior United States District Judge Delbert E. Metzger, of the United States District Court for the District of Hawaii, and United States District Judge George B. Harris, of the Northern District of California.

The court found that appellees' complaint for injunction and for redress of deprivation of civil rights stated a case of both federal and equitable jurisdiction, and after full hearing on the merits, made findings of fact and entered its decrees (a) adjudging the unlawful assembly and riot act and the conspiracy act of the Territory of Hawaii void as unconstitutional; (b) restraining the appellants, Ackerman, Bevins, Crockett and Lane, and their respective agents, deputies and successors in office, from proceeding with the prosecution of the individual appellees under any complaint or indictment based on these acts; (c) declaring the method of selection of the Grand Jury of Maui County in violation of constitutional requirements; and (d) granting the benefits of the decree to the union appellee and appellees Kawano and Rania in their representative capacities.

The cases are appealed to this Court under Section 1291 of the new Judicial Code and in accordance with the decision of the United States Supreme Court in *Stainback v. Mo Hock Ke Lok Po*, 336 U.S. 368.

STATEMENT OF THE CASE³

A. Parties, Issues, and Jurisdiction

These two cases are civil rights cases brought to redress the deprivation under color of territorial law of constitutional and federal rights. The appellees, plaintiffs below, are an unincorporated association and labor union, two officers and members of the union in their representative capacity on behalf of the 30,000 members of the union, and 127 individuals threatened with specific prosecutions under

³ Unless otherwise indicated, the facts in the Statement of the Case appear in the Opinion, 82 F. Supp. 65, R. 366-520, R. 2-26, 31-34, R. 12,300, 2-34.

color of one or both of the two territorial laws found by the court below to be void as unconstitutional.⁴

The individual appellees and the members of the union are daily wage earners in the sugar and pineapple and other industries of Hawaii. The individual appellees are ethnologically (or as a matter of mores of the Islands) members of races other than the Caucasian race.

The jurisdiction of the District Court was found to rest on Sections 1343 and 1337 of Title 28 of the Revised Judicial Code and the Civil Rights Act.

The appellants at both numbers are the Attorney General of the Territory, the Chief of Police of Maui County, and the former County Attorney of Maui County, and his Deputy, at the time the acts complained of occurred. The action as to other defendants named in the complaint was dismissed by the District Court.

The appellees' complaints alleged that strikes were conducted by the union in the sugar and pineapple industries in 1946 and 1947; that in furtherance of the objectives of the strike, that is, the improvement of wages, hours and conditions of employment, the appellees engaged in lawful, peaceful and constitutionally protected activities of speech, press and assemblage, and of peaceful picketing.

The complaint, at Number 12,300, alleged that the appellant Chief of Police caused the individual appellees to be arrested and charged by police complaint with purported violations of the territorial unlawful assembly and riot act; that the appellants Ackerman, Bevins and Crockett sought to present purported criminal charges, framed on the police complaints, to the grand jurors of Maui County; that the

⁴ The 52 individual appellees, other than Kawano, at No. 12,300, are threatened with prosecutions. Since the unlawful assembly act complained of is a felony, prosecution can be only by indictment of the grand jury. An indictment under both the unlawful assembly act and the conspiracy act has been returned, under circumstances hereafter described, against the individual appellees, other than Rania, in 12,301.

unlawful assembly and riot act, under which the appellants sought to present purported criminal charges, is unconstitutional in that it deprives the appellees of their rights of free speech, press and assembly for reasons set out in the complaint, and will subject them to criminal prosecution if they exercise their constitutional rights; that certain of the individual appellees had filed motions and challenges to the grand jury and to the methods employed in selecting its members; that the grand jury had been selected and composed in a manner violating the constitutional rights of these appellees, for reasons set out in the complaint, and that challenges and motions had been held to be without merit in a hearing in which these appellees were denied due process of law.

The complaint at Number 12,301 differed in that it also attacked the conspiracy statute of the Territory; it alleged that the appellants had presented purported criminal charges of alleged violation of the unlawful assembly and riot act and the conspiracy act to the grand jurors against the individual appellees; that the grand jury, to which such purported charges were presented, was selected and composed in a manner which violated the appellees' rights.

The complaints at both numbers alleged that unless the unlawful assembly and riot statute and the conspiracy statute were held to be unconstitutional and void, the appellees would be deprived of their constitutional rights, and that it was necessary and imperative for the court to assume jurisdiction and restrain and enjoin the appellants in order that appellees have an impartial, representative and democratic grand jury; that appellees had no plain, adequate or speedy remedy at law, and that unless appellants were enjoined as prayed, appellees would be deprived of rights secured to them by the Constitution and laws of the United States; that the union cannot function, exercise its property and personal rights in the County of Maui so long as its members are subject to indictment by illegally constituted

grand juries, and subject to prosecution under these unconstitutional statutes, because of the fear and intimidation of its members engendered by the threat of punishment for the exercise of rights guaranteed by the Constitution.

Appellees prayed that the court issue temporary and permanent injunctions prohibiting the enforcement of these statutes against the appellees and enjoining the submission to the grand jury of purported charges based on the unlawful assembly and riot act; that the court declare the statutes to be unconstitutional and adjudge the methods used in selecting the grand juries of Maui County to be unconstitutional and contrary to law.

B. Proceedings in the District Court

On the basis of the showing made of the unconstitutionality of the statutes, and irreparable injury to appellees, a temporary restraining order was issued by Federal District Judge Metzger and confirmed, though modified in form, after the hearing on the return to the order to show cause and motion to dissolve it. (R. 27, 99-103.)

Pursuant to the prayer of the complaint, and in accordance with the state of the law as it existed under the decision in *Mo Hock Ke Lok Po v. Stainback*, 74 F. Supp. 852, a three-judge court was convened to hear the case.

The technical and legal objections here raised by appellants to the complaint and its sufficiency, the jurisdiction of the court, and the propriety of the parties, were considered by the District Court at every stage of the proceeding and overruled, except in regard to the dismissal as to certain of the defendants.

The reasons stated by the District Court for overruling the motion to make more definite was that:

the protracted arguments demonstrated that the defendants and their able counsel are fully informed of the nature of the complaints and that no further par-

ticularization or specification of the plaintiffs is necessary. (R. 335)

The District Court overruled the motions to dismiss and for summary judgment, finding a likelihood that the introduction of evidence would make the grave constitutional issues clearer. *Borden's Farm Products Co. v. Baldwin*, 293 U.S. 194, 213. See also *Gibbs v. Buck*, 307 U.S. 66, 76. (R. 335-336, R. 379, note 6.)

The parties and the court agreed to combine the hearings on the temporary and permanent injunction.

C. Evidence and Findings of Fact and Conclusions of Law of the District Court

1. Evidence and Findings of Fact Relevant to Both Cases

Upon the hearing on the merits, the appellees showed a persistent and long continued policy of the appellant law enforcement officers of singling out members of the union, including the individual appellees, for harsher treatment than other persons in the community for like offenses, and a persistent policy of treating picketing as conspiratorial in nature, invoking the unconstitutional twenty-year felony of unlawful assembly and riot and the conspiracy act against the members of the union for trivial incidents and minor law infractions occurring during the course of picketing activities.

The extraordinary and exceptional nature of the economic and sociological background of Hawaii's industrialized agriculture, in which the labor disputes involving appellees arose, is described and found by the court from standard and accepted sources. (R. 380-390)

The use and application of these two statutes in labor disputes and a picture of the way laborers engaged in labor disputes have in the past fared in territorial courts is shown in a Memorandum on Labor and the Law, filed by appellees at the request of the court. (Appendix I, at page 1.)

The District Court found as fact:

That the union has spent in excess of one-third of a million dollars in Hawaii since 1944 in organizing 30,000 workers in the sugar, pineapple and other industries; that large sums of money are spent monthly in the administration and servicing of the locals; that the money is contributed by the members through monthly dues.

That the purpose of the union is to improve the wages, hours and working conditions of its members in these industries; that the union and its members have no way of achieving their objectives except by striking, if collective bargaining and voluntary mediation fails to settle disputes because the employers of the members of the appellee union all refuse to submit contract issues involving wages to arbitration.

That wages for common labor had been increased from \$1.84 a day, fixed by the federal government in 1943, to which a 15% bonus was added, to in excess of eight dollars a day under existing union contracts.

That the fear generated by the mass arrests made by appellants under color of the unlawful assembly and riot statutes against the individual appellees in these cases for minor disturbances on picket lines has seriously weakened the ability of the union to strike.

That mass arrests during the pineapple strike, under color of these statutes, for picket line disturbances broke the strike and demoralized many of the workers, who left the union; that after the strike, membership on the island of Lanai, where the mass arrests occurred, dropped from 1300 to 800.

That the unlawful assembly and riot acts substantially affected the course of labor-management relations in Hawaii as the union felt it would be suicide to strike for higher wages in the face of the consistent established use of the 20-year felony of unlawful assembly and riot for minor disturbances on picket lines.

That during the sugar strike, 21 members of the union were charged with and indicted for unlawful assembly and conspiracy; that the charges were dropped two months after the Territory-wide strike was over and *nolo contendere* pleas accepted to misdemeanor assault and battery charges.

That during the pineapple strike, 83 members of the union were arrested; that the charges were dropped, after the strike, for lack of evidence. Appellees introduced evidence to show that these arrests were made and the defendants in the case held for five hours purportedly for violations of the unlawful assembly and riot act, and that finally a charge of obstructing the highway was made and dropped after the strike for lack of evidence.

That the mere existence of the statute has been used by Territorial courts to justify sweeping injunctions against peaceful picketing except as limited to three.

That excessive bail⁵ was exacted in these cases; that mass arrests were made in many instances where no evidence of even presence at the scene of the alleged incident existed, other than pictures concededly taken at the scene both before and after the incidents occurred; that the reported cases indicated that the unlawful assembly and riot statutes had been used only against labor while engaged in labor disputes, since Hawaii became a part of the United States.

The present suits grew out of three incidents which occurred during the 1946 sugar strike and 1947 pineapple strike.

The 1946 sugar strike commenced on September 1, 1946 and lasted until November 19, 1946, except at Pioneer Mill Company, Lahaina, Maui, where it continued until January 2, 1947 because that company discharged for purported violations of its house rules ten of its employees upon their being charged with unlawful assembly, riot and conspiracy. (R. 1191, 1196-1197.)

⁵ Bail in assault and battery and other misdemeanors ordinarily does not exceed \$25.00 in Hawaii.

The 1947 pineapple strike lasted from July 10 to July 15, 1947.

2. The Paia Incident—12,301

The court's finding of facts on this incident are set forth at pages 391-401 of the Record. The appellants do not complain of these findings. Indeed, they cannot, since the District Court accepted appellants' version of the facts as to the incident, even though appellees' witnesses and the pictures introduced in evidence give a substantially different version.

The District Court's findings on the Paia incident show: Beginning September 1, 1946, 20,000 sugar workers in the Territory went on a strike which was authorized by a vote of 94 percent of the union's members. The 79-day strike was remarkable in its freedom from incidents involving infractions of the law (R. 399, note 25). At Paia, Maui, where the Maui Agricultural Company is located, 1,000 employees were on strike. Paia is a company town of 3,000 inhabited almost wholly by the employees of the company, including members of the union and their families.

For the first 45 days of the 79-day strike, large groups of pickets peacefully picketed the premises of the company. Police were present at most times and raised no objections. On the 46th day of the strike, October 16, 1946, there was a moving picket line estimated varyingly from 250 to 500 persons. Five employees desiring to return to work and 18 to 20 police officers were present. When these employees approached the line and it did not open up, Assistant Chief of Police Freitas called the pickets together into a group and read them the loitering statute which provides:

Any person who shall loiter or loaf or idle upon any public highway, street or sidewalk, thereby impeding or rendering dangerous the passage of pedestrians or others lawfully using the public highway, street or sidewalk, or thereby in any way imperiling the public wel-

fare or thereby tending in any way to cause a breach of the peace, is guilty of a misdemeanor and upon conviction thereof shall be punished by a fine of not less than \$25 nor more than \$250 or imprisonment for not less than thirty days nor more than 90 days.

The picket line was not opened and after this second attempt, the five men left. No order to disperse was made at any time by any of the police officers present.

The whole incident took no more than three minutes. Assistant Chief of Police Freitas testified that he congratulated the people on keeping their heads and that they applauded him. He testified that he thanked one of the plaintiffs, Joseph Kaholokula, for his assistance in getting the pickets to listen to him, and told him that he was glad nothing serious had occurred. He said he might make a test case of the loitering statute against four or five of the pickets.

No arrests were made at that time, and none were made until at least three days later when the same police officer swore out a complaint charging approximately fifty of the appellees with unlawful assembly and riot.

Appellees were arrested, questioned without being warned of their rights and required to put up bail ranging from \$1,000 to \$100. Subsequently seventy-nine persons, including four shown not to have been on the picket line that morning, were indicted for unlawful assembly and riot.

They were arraigned before the Second Circuit Court and demurred to the indictment. When the demurrer was overruled, an interlocutory appeal was taken to the Supreme Court of the Territory which held the indictment defective but upheld the constitutionality of the statute on November 26, 1947.

While the case was still pending before the Supreme Court, and before the 20-day period allowed for rehearing expired, and before the remittitur went from the Supreme Court to the Second Circuit Court, and at a time when the appellants were restrained by order of the District Court

from proceeding to indict the individual appellees in 12,300 because of the alleged unconstitutionality of the unlawful assembly statute as well as the unconstitutionality of the method of selection and composition of the 1947 grand jury, the appellants, without notice to appellees, presented and procured an indictment under the challenged statute from the challenged jury.

3. The Lanai Incidents—12,300

The District Court's findings of fact on the Lanai incidents are set forth at pages 402-409. The court, in these incidents, also adopted as facts testimony of appellants' witnesses.

In sum, the evidence shows that during the 1947 pineapple strike, which lasted from July 10 to July 15, 1947, the employees of the Hawaiian Pineapple Company on the Island of Lanai, which is owned by the company, were on strike.

The population of Lanai is approximately 3,000 and is made up primarily of the employees of the company, including the 1,300 agricultural workers, members of the appellee union, and their families.

Most of the employees live in the company town of Lanai City, which is inland about seven miles from the harbor where the harbor incident involving 47 of the individual appellees occurred.

Present at the time were six police officers, a number of union men, spectators and eight company supervisors or executives. On the dock were 11 bins of six-day old pineapple picked before the strike. A barge dispatched from Honolulu arrived about 4:00 o'clock to pick up the pineapple.

The court notes that the evidence shows that a barge customarily carries 152 bins of pineapple, and that pineapple is customarily shipped within 48 hours after picking.

When the barge docked and the company supervisors

started to load the pineapple, some of the union pickets crossed the kapu (no trespass) line and threw pineapples out of the bins and punched one of the supervisors and chased another of the company men operating the crane.

The evidence offered by appellants and accepted by the court in its findings shows at its very worst that two persons were assaulted and battered and some pineapples were thrown out of bins.

Three photographers, including one of the police officers, were stationed at various angles taking pictures. Pictures concededly taken at the harbor the morning of the incident and after the incident was over were used for identification in the mass arrests that followed.

Eleven of the appellees in 12,300 were arrested on the 15th and held incommunicado, and finally released on excessive bail on a charge of unlawful assembly and riot. About two weeks later, 51 additional persons, including 36 of the individual appellees in 12,300 were arrested and charged with unlawful assembly and riot. 4 were dropped before the preliminary hearing, and 12 thereafter. One also was dropped on the mistaken impression that he didn't belong to the union.

The Kalua incident involved assault and battery on two non-union employees who worked throughout the strike. Five of the individual appellees were arrested, charged with unlawful assembly and riot as a result of this incident, and released on excessive bail of \$1000 each.

4. The Grand Jury Issue

The District Court found that the evidence before the court showed that the 1947 Maui County Grand Jury was not impaneled in accordance with law. It found that although at the hearing of the challenges by certain of the individual appellees at Number 12,300 but a limited review of the methods employed to select the grand jury was permitted, there was sufficient evidence in the record to demon-

strate the erroneous method employed in selecting the grand jury.

The District Court found that 84% of the persons selected and listed for grand jury service in 1947 came from the ranks of the employer-entrepreneur group and their salaried (non-labor) employees, and that all other groups in the community, including labor, had approximately a 16% representation, although male laborers in Maui County comprised 79% of the total male population of the County.

The District Court found that the haole group in Maui County comprised but about 3.6% of the population, but the grand jury contained 21 haoles or 42% of the list.

It found that the percentage of Koreans, Hawaiians, Puerto Ricans and Filipinos on the list was zero, and that Filipinos constituted the second largest national group in the County as well as in the Territory, there being over 10,000 Filipinos in the County. The court also found that appellees had shown that there were qualified Filipinos.

The District Court found on the basis of the testimony of Jury Commissioner Pombo, as well as the composition of the grand jury, that appellees had proved a deliberate exclusion of Filipinos from grand jury service as well as a deliberate weighting of the grand jury list in favor of haoles and business men and against the laboring men of the community.

It found that the selection of jurors was made primarily from persons personally known to the jury commissioners.

The District Court also found that the commissioners used a questionnaire requiring prospective jurors to state where they were born and the "nationality" of both parents; that the questionnaire was not shown to have been employed for any purpose within the law and was in derogation of Section 83 of the Hawaiian Organic Act requiring the selection of jurors without reference to the race or place of nativity of the jurors.

The District Court concluded that the method of selection of the 1947 Maui County Grand Jury, within principles well established and clearly defined by the United States Supreme Court, was in violation of the Fifth and Sixth Amendments and was not a fair cross-section of the community of Maui County.

5. Bad Faith of Prosecutions

On the basis of the record before it, the District Court found that the criminal prosecutions against the individual appellees were carried on by appellants for the purpose of attack upon a labor movement rather than for the ends of justice. In reaching this conclusion, it relied on all facts found in the case, and cited specifically:

1. (a) The mass arrests shown by the record in the Paia incident, the harbor incident, and on Oahu;

(b) The naming of persons as defendants in criminal proceedings from photographs taken both prior and subsequent to incidents alleged as violations of the unlawful assembly and riot act;

(c) The fact that no arrests were made during the course of the incidents charged as violations of the unlawful assembly and riot act;

(d) The excessive bail required of many of the individual appellees in the instant cases;

2. The fact that Assistant Chief Freitas read the loitering law and not the unlawful assembly and riot act to the strikers and did not contemplate the swearing out of a complaint against the individual appellees under this act until instructed to do so by the prosecuting officers.

3. The repeated selection of the unlawful assembly and riot act with its heavy penalties as vehicles for the prosecution of comparatively minor infractions of the criminal laws;

4. The haste with which prosecuting officers procured the second indictment against the individual appellees in case Number 12,301 after the first indictment was held invalid by the Supreme Court of Hawaii;

5. The fact that these laws were not invoked except in connection with labor disputes during the life of the Territory;

6. The fact that the maximum penalty under the unlawful assembly and riot act was increased from five years imprisonment to twenty years imprisonment after a strike of Filipino workers in 1924.

6. Irreparable Injury, Exceptional Circumstances, and Unconstitutionality of Statute

On the basis of its findings of fact, the District Court found that exceptional circumstances existed and that an equitable cause of action had been made out.

The District Court found the unlawful assembly and riot act and conspiracy act of the Territory unconstitutional on their face; that the impact of the two statutes as employed and as about to be employed by the appellants is such as to disrupt immediately any substantial possibility or opportunity for genuine collective bargaining between the employers of the sugar and pineapple industries and their employees; that the very existence of these two statutes as well as the manner of their enforcement by appellants so heavily weighted the scale in favor of the employer and against the employee as to render fair collective bargaining a virtual impossibility; that on the basis of the evidence presented, equitable and amicable relations between employers and employees in Hawaii are impossible while the statutes stand; that the repercussions that arise from the enforcement of these statutes in Hawaii are such as to cause irreparable damage to all labor relations in Hawaii.

The District Court found other and equally cogent reasons why injunctions prayed for must issue, based upon the court's findings that the criminal prosecutions were not brought by appellants in good faith; and that the violation of federal rights implicit in the selection of the grand jury was such as to violate constitutional standards made explicit by rulings of the United States Supreme Court.

D. Decrees and Judgments

On the basis of its findings of fact and conclusions of law, set forth in its opinion, the District Court for the District of Hawaii, sitting *en banc*, made and entered its decree granting judgment to appellees and declaring the unlawful assembly and riot act and the conspiracy act of Hawaii void as unconstitutional, enjoining the prosecution of appellees under any complaint or indictment based on these laws, and holding void the indictment in 12,301 because of the illegal constitution of the grand jury.

ISSUE IN THIS COURT

The question before this Court is whether, taking the record as a whole, substantial justice has been done. Appellees submit that it has, that appellants' attacks on jurisdiction are not well founded, and that other legal and technical objections, singly or in sum, do not present facts showing any substantial prejudice to appellants. The decrees and judgment should therefore be affirmed.

SUMMARY OF ARGUMENT

A. Theory of the Case

Appellees' theory of their case, as set forth in their complaint and as presented and argued before the District Court at every stage of the proceeding, and in the presentation of evidence of deprivation of federal rights, bad faith in the prosecutions and denial of equal protection of the laws, was based squarely on rules laid down in the decisions of the United States Supreme Court in *Hague v. CIO*, 307 U.S. 496, *Douglas v. Jeannette*, 319 U.S. 157, and *American Federation of Labor v. Watson*, 327 U.S. 582.

In *Hague v. CIO*, the Supreme Court held that federal courts have jurisdiction of suits brought under the Civil Rights Act, without regard to jurisdictional amount, to redress the deprivation of federal rights. The court declared void on their face and restrained the enforcement of two ordinances of Jersey City, one of which required permits to

be obtained for the holding of parades and public assemblies, and authorized the Director of Public Safety to refuse a permit only for the purpose of preventing riots, disturbances and disorderly assemblages.

In *Douglas v. Jeannette*, the Supreme Court again held that federal district courts have jurisdiction of suits for injunction brought under the Civil Rights Act, without regard to jurisdictional amount, to redress the deprivation of federal rights under an unconstitutional ordinance and to restrain its enforcement. Notwithstanding the authority of the District Court to hear and decide the case, the Court said that as a matter of discretion federal courts should refuse to interfere with criminal proceedings in state courts "save in those exceptional cases which call for the interposition of a court of equity to prevent irreparable injury which is clear and imminent."

Appellees met every standard laid down by the court for an exceptional case.

First, the Supreme Court said that courts of equity do not ordinarily restrain criminal prosecutions since no person is immune from criminal prosecutions in good faith for alleged criminal acts, and the constitutionality can be as readily determined in the criminal case as in the suit for injunction.

This appellees met by showing that appellants were not acting in good faith in arresting and prosecuting appellees under color of the unconstitutional laws complained of, and that the grand jury to which appellants presented or threatened to present these purported charges was illegally constituted.

They showed that the question of constitutionality could not be as readily determined in the criminal proceedings since the Territorial Supreme Court had upheld the statute as valid on its face and had in effect broadened its scope in a proceeding from which no appeal could be prosecuted.

Second, the Supreme Court said that the state courts are

the final arbiters of the meaning and application of the statute. Here the Territorial Supreme Court had already interpreted the statute and held it valid, so that a decision as to whether the statute, as so interpreted, was valid was ripe for federal decision.

Third, the Supreme Court said that the arrest by federal courts of the processes of the criminal law within the states, and the determination of questions of criminal liability under state law by a federal court, are to be supported only on a showing of danger of irreparable injury both great and immediate.

What constitutes a showing of irreparable injury the court made specific in *American Federation of Labor v. Watson*. There, the court held that the impact upon a labor union and the threat of disruption of a system of collective bargaining protected by federal law was such as to meet this strict test. The District Court found appellees' evidence met this test.

In *Screws v. United States*, 325 U.S. 91, in upholding the criminal conspiracy section of the Civil Rights Act—which is in *pari materia* with the section affording civil relief—the Supreme Court said that “to deprive a person of a right which has been made specific either by express terms of the Constitution or laws of the United States or by decisions” of the Supreme Court interpreting them supplied the specific intent necessary to constitute wilful deprivation of rights. A local officer, the Court said, who persists in enforcing a type of ordinance which the Supreme Court has held invalid as violative of the guarantees of free speech or freedom of worship, or a local official who continues to select juries in a manner which flies in the teeth of decisions of the Supreme Court knows exactly what he is doing.

He violates the statute not merely because he has a bad purpose, but because he acts in defiance of announced rules of law. He who defies a decision interpreting the constitution knows precisely what he is doing.

Appellees showed that the unlawful assembly and riot act of the Territory parallels in every respect, except the death penalty, the Riot Act of George the First, which the Supreme Court in *Bridges v. California*, 314 U.S. 252, specifically cited as a measure which the Bill of Rights prohibited the American Congress from passing.

The conspiracy act on its face falls clearly within that type of vague and indefinite statute which the Supreme Court struck down in *United States v. L. Cohen Grocery Co.*, 255 U.S. 81, on the ground that

to attempt to enforce the section would be the exact equivalent of an effort to carry out a statute which in terms merely penalized and punished all acts detrimental to the public interest when unjust and unreasonable in the estimation of the court and jury.

Appellees met with exactitude the quantum of proof held sufficient to show a deliberate and substantial exclusion from the grand jury list of persons on account of race, in a long line of cases from *Strauder v. West Virginia*, 100 U.S. 303, through *Patton v. Mississippi*, 332 U.S. 463, and as to exclusion of wage earners, the test laid down in *Thiel v. Southern Pacific Co.*, 328 U.S. 217. Appellees showed that the 1947 grand jury was illegally composed within the principles laid down in *Fay v. New York*, 332 U.S. 261.

These specific decisions and matters had been presented to the territorial courts, which had refused to give them effect.

There are four major premises under the theory of the case that will be developed: the federal and equitable jurisdiction of the District Court, the unconstitutionality of the unlawful assembly act, of the conspiracy act, and of the method of selection of the grand jury. Appellants attack each of these premises in sum and in fragment.

I.

FEDERAL AND EQUITABLE JURISDICTION

Under this section Points I, II, V, VI, VII, VIII, IX, X, and XII of appellants' Brief—all of which attack the power of the court to hear and determine the cause, or the propriety of the exercise of its equitable discretion for legal or factual reasons—are discussed.

Appellees show that the authorities cited by appellants are not apposite and do not sustain their attack on the jurisdiction of the District Court or the propriety of the exercise of its equitable discretion.

The power of federal district courts to hear civil rights suits for injunctive relief, and where exceptional circumstances exist and irreparable injury will result, to restrain state or territorial officers acting under color of unconstitutional statutes cannot be questioned as appears from the authorities cited in the foregoing statement of the theory of appellees' case, and the authorities discussed in this section of appellees' brief.

II.

THE UNCONSTITUTIONALITY OF THE UNLAWFUL ASSEMBLY AND RIOT ACT

Under this section the contentions made in Point III of appellants' Brief are considered. The clear-cut condemnation of statutes of this type by the United States Supreme Court in a long line of decisions in First Amendment cases from *Near v. Minnesota*, 283 U.S. 697, to *Bridges v. California*, 314 U.S. 252, is shown. The doctrine of *res adjudicata* has no application to the circumstances of this case. Even if it were otherwise, the union, the class representatives and four of the individual appellees would not be affected.

The Supreme Court of Hawaii specifically upheld the statute on its face without limiting or narrowing it in any way. Indeed, the sweep of the statute was broadened by the

construction that an order to disperse was not required before the heavy penalties of the statute could be incurred.

If appellants' contention that the Federal District Court was bound to reach the same conclusion as to constitutionality that the Supreme Court of Hawaii reached were correct, the results would be a revolution in law. Every three-judge court convened to hear a challenge to the constitutionality of a state statute would be bound by the state court's decision. It is scarcely a worthy argument. See *Lane v. Wilson*, 307 U.S. 268.

The Supreme Court of Hawaii, having judged and upheld the statute on its face, the doctrine of deference is not apposite. Even so, the District Court did note that the Supreme Court of Hawaii held an order to disperse not necessary and considered the statute in that light. The statement of the Supreme Court that the statute has no relation to peaceful picketing says no more than that the statute is constitutional in the opinion of the court. This is clear from the fact that the test of accountability, as appellants call it, was framed by the Supreme Court of Hawaii wholly in the words of the statute and by reference to sections of the statute.

The repeal of the statute, except as to appellees, and the reduction of the penalty under the new law even as to appellees, does not affect the question of constitutionality. It throws considerable light on the case as an admission against interest of appellants as to the grossly excessive nature of the penalty of twenty years. The repealing bill was sponsored by appellants. It is tantamount to an admission that the District Court and appellees were justified in their condemnation of the penalty provisions of the law. As originally presented to the Legislature by the appellant attorney-general the bill sought to preserve the right to proceed against appellees for the twenty-year maximum, although the penalty under the succeeding act was reduced by eighteen years. See Minority Report on House Bill 442, appendix II. It

does not appear whether the appellant attorney-general was responsible for the largesse, or the Legislature.

III.

THE UNCONSTITUTIONALITY OF THE CONSPIRACY ACT

Under this section the contentions made by appellants in Point IV of their Brief are considered.

Appellants tacitly concede the unconstitutionality of a portion of this act and that the indictment against the appellees in 12,301 is in part based on the unconstitutional portion. They urge, however, that the District Court should have let the criminal case proceed since a portion of the statute might be held to be valid.

This statute has been authoritatively construed by the Supreme Court of Hawaii in *Territory v. Soga*, 20 Haw. 71. The appellants, however, do not seek to determine its construction or to invoke the rule of deference on this statute. They remain silent as to the existence of the case.

As authoritatively construed the conspiracy statute permitted the conviction of four strike leaders of the 1909 strike of Japanese workers, two of whom were newspaper editors. Under the complaint the defendants were charged with conspiring to impoverish a sugar company by inciting laborers to ask for higher wages. The means used were newspaper articles, a play and speeches. The court said that it was a fair inference that these articles were susceptible of being interpreted as urging and approving violence by the fact that some violence subsequently occurred. The defendants were sentenced to ten months imprisonment and fines and costs. Most of the evidence was obtained by dynamiting the safe of one of the defendants. Prosecutors were the attorneys for the sugar company. See Memorandum on Labor and the Law, appendix I, p. 14.

The statute is clearly void.

IV.

THE GRAND JURY ISSUE

Under this section appellants' contention with respect to the grand jury issue in Point XI of their Brief is considered.

The District Court held that appellees had no opportunity to challenge the grand jury under the circumstances in which appellants procured their indictment, and that it was doubtful if territorial law afforded appellees a remedy. The District Court held it had jurisdiction to hear and decide the question presented, which was whether the appellees were being deprived of federal rights. The District Court further held that even if this were not so, since it had acquired jurisdiction, on adequate grounds, that its decision should not be truncated. Appellants' arguments to the contrary are not persuasive.

Under the Civil Rights Act, one may sue to redress deprivation of a federal right even without exhausting remedies under state law. *Lane v. Wilson*, 307 U.S. 268, *Bomar v. Keyes*, 162 F 2d 136. The denial of a fair and representative grand jury is *per se* a denial of equal protection of the laws. It is to be noted that the relief sought is declaratory and not injunctive, and that a real controversy exists, the appellees having been indicted. It is also true that the denial of this right leaves the state court without jurisdiction to try a defendant under an indictment returned by such a grand jury. *Patton v. Mississippi*, 332 U.S. 463.

A showing that there has been no Filipino on the grand jury of Maui County in thirty years; that Filipinos constitute twenty per cent of the population of the County; that there are qualified Filipinos; that jury questionnaires of Filipinos showing the same qualification as persons selected for jury service were marked "not qualified" and questionable; and the testimony of a jury commissioner that no Filipinos were selected because they had men that were better;

when a large number of the individual appellees are Filipinos, is a sufficiently clear showing to bring appellees explicitly within the scope of Supreme Court decisions declaring such exclusion and discrimination a violation of constitutional rights.

A showing that 84 per cent of a jury list is composed of representatives of the employer-entrepreneur group which comprises 15 per cent of the community and that the same percentages existed for at least the past five years, coupled with a showing by testimony of a jury commissioner that business men and their employees were better jurors than truck drivers, that male workers constituted 79 per cent of the population and that there were no agricultural workers on the list although 49 per cent of the population were agricultural laborers and all of the individual appellees belong to the excluded class is a sufficiently clear showing to warrant a conclusion that there was a deliberate and substantial weighting of the jury in favor of business men and against laborers and to condemn the method of selection as a denial of a grand jury properly constituted within the rule of the *Thiel* case.

A showing that the grand jury list contained 42 per cent haoles—defined as Caucasians exclusive of Portuguese—and with a gloss of rank or economic status—when haoles constituted only 3.5 per cent of the community, coupled with the testimony of a jury commissioner that he selected haoles because they wanted to run the country and they owned the country and that all the individual appellees were non-haoles was a sufficiently clear showing to warrant a finding of deliberate and substantial weighting of the jury based on race and economic status and to condemn a jury so selected as discriminatory.

ANSWERING ARGUMENT

I. THE DISTRICT COURT HAD JURISDICTION AND THE EXERCISE OF ITS DISCRETION WAS PROPER.**A. The District Court was Properly Constituted as the District Court for the District of Hawaii, Sitting En Banc (B. 43-45).**

The District Court held that if the requirements for a three-judge court under Section 2281 of Title 28 of the new Judicial Code do not apply to Hawaii—as the United States Supreme Court has since ruled in *Stainback v. Mo Hock Ke Lok Po*, 336 U.S. 368—that the three judges, being either in the active service of the District Court for the District of Hawaii, or duly designated and assigned to sit as district judges of that court, were authorized to hear and determine the case as the Federal District Court for the District of Hawaii, sitting *en banc*. (R. 432-435, 521-522, 543-500; 12,300, R. 89-96.)

Appellants dispute this. (B., 43-45) Since it is clear that this Court has the right to review the decision under the *Mo Hock* case, and since all three judges are clearly authorized to sit under the provisions of Section 132 of Title 28 of the new Judicial Code, which specifically applies to Hawaii, there is no question of the *power* of the three judges to sit as the District Court for the District of Hawaii.

Apparently, appellants wish to cut down the stature of the decision and to insist that this Court, ostrich-like, look upon the unanimous decision of three federal judges as if it were the decision of one judge.

B. The Jurisdiction of the District Court Rests on Section 1343 of Title 28 of the New Judicial Code and the Civil Rights Act and on Section 1337 of the New Judicial Code. Alternatively, Jurisdiction Exists Under Section 1331 of the New Judicial Code.**1. Existence of Jurisdiction Under Section 1343 and the Civil Rights Act (B. 45-48, 49-50, 75-82).**

The District Court held that it had jurisdiction of the parties and of the deprivation of constitutional rights com-

plained of under Section 1343 of the new Judicial Code⁶ and the Civil Rights Acts, R. S. Section 1979, 8 U.S.C.A. 43, R. S. Section 1977, 8 U.S.C.A. Section 41, without regard to jurisdictional amount. (R. 436-438)

Appellees candidly urged before the District Court and urge here that the District Court has jurisdiction under 1343 and the predecessor of this section, Section 24 (14) of the old Judicial Code, 28 U.S.C.A. 41 (14), without regard to jurisdictional amount, in spite of the conflict in decisions.⁷ Appellants concur that this section confers jurisdiction of deprivation of constitutional and federal rights on individuals in Hawaii in a proper case, without regard to jurisdictional amount, despite the absence of the word "territory." (B. 46-47)

This question is of great importance to Hawaii and a resolution of the conflict in decisions is certainly desirable.

Since the right to sue is clearly given under Section 43 of Title 8, and the problem is the imperfect creation of a forum, *Bell v. Hood*, 327 U.S. 678, would seem to be conclu-

⁶ Both Section 24 (14) of the old Judicial Code, cited in appellees' complaint and Section 1343 of the new Judicial Code, effective at the time of decision are set forth in full at page 165 of the Appellants' Brief.

⁷ The first decision on the right of persons to maintain an action based on the Civil Rights Act without proof of jurisdictional amount was *Alesna v. Rice*, Civil No. 769 in the records of the United States District Court for the District of Hawaii, in the Ruling Upon Motion for a Preliminary Injunction, filed February 25, 1947. This ruling held 41 (14) applicable to Hawaii.

The next decision on the point, *Mo Hock Ke Lok Po v. Stainback*, 74 F. Supp. 852, reversed on other grounds, 336 U.S. 369, denied the application of 41 (14) to Hawaii.

In *Alesna v. Rice*, 74 F. Supp. 865, affirmed on other grounds, 172 F. 2d 176, the question was re-examined by the District Court in the light of the *Mo Hock* decision and its earlier decision upholding jurisdiction reaffirmed. Here the District Court held that Section 1343 of the new code applies to Hawaii basing its decision in part on the full status given to the United States District Court for the District of Hawaii under the new code, and without expressing an opinion as to the old code section. See full discussion of problem, *Alesna v. Rice*, 74 F. Supp. 865, 868.

sive that the word "state" should here be construed to include "territory":

And it is established practice for this Court to sustain the jurisdiction of federal courts to issue injunctions to protect rights safeguarded by the Constitution and to restrain individual state officers from doing what the Fourteenth Amendment forbids the State to do. Moreover, where federally protected rights have been invaded, it has been the rule from the beginning that courts will be alert to adjust their remedies so as to grant the necessary relief. And it is also well settled that where legal rights have been invaded and a federal statute provides for a general right to sue for such invasion, federal courts may use any available remedy to make good the wrong done.

Conceding the right of the individual appellees to sue under Section 1343 of the new Judicial Code, appellants assert that the District Court erred in holding that the union appellee may maintain the suit without showing of jurisdictional amount. The District Court's reasoning and authorities seem unassailable on this issue. (R. 436-439, 513-515, B. 45-46)

Appellants point to the fact that only the individual plaintiffs were permitted to sue in *Hague v. CIO*, 307 U.S. 496. They misconstrue the case and misstate the District Court's position. That ruling was based on the opinion of the majority of the justices in the *Hague* case that the right to assemble and discuss the benefits of national labor legislation is a privilege and immunity of citizenship. Only natural persons are protected by the privileges and immunities clause. Justice Stone placed jurisdiction on the due process clause in his dissenting opinion, concurred in by Mr. Justice Reed and, as to this point, Mr. Chief Justice Hughes. In *Douglas v. Jeannette* Mr. Justice Stone wrote the opinion of the court, basing it on due process.

Appellees believe that the situation in a territory is different than in a state. Neither the privileges and immuni-

ties clause nor the due process clause is necessary to transmit the guarantees of the First Amendment. As Congress is prohibited directly from passing laws abridging free speech by this amendment, so is a territory which exercises only power delegated by Congress. Deprivation of rights under both the First and Fifth amendments is asserted by appellees.

As the District Court points out, corporations are "persons" within the meaning of the due process clause of the Fourteenth Amendment and are entitled to protection against the abridgment of a free press by state action. *Near v. Minnesota*, 283 U.S. 697, *Grosjean v. American Press*, 297 U.S. 233. See also Rule 17b of the Rules of Civil Procedure on capacity to sue, Rule 23 on class actions, *Stapleton v. Mitchell*, 60 F. Supp. 51, and *AFL v. Watson*, 327 U.S. 582, where an unincorporated association was permitted to test the validity of a provision of the constitution of Florida. The court, however, found it unnecessary to pass on this point, finding jurisdiction under the commerce section.

The appellee union and its officers being an association of natural persons are entitled to protection against deprivation, under color of territorial law, of rights guaranteed by the Constitution and federal law.

They are therefore, as the District Court held, entitled to maintain a civil rights suit under Section 1343, without regard to jurisdictional amount, as are the individual appellees.

The District Court held that appellees' complaint set forth and that they proved a cause of action under the Civil Rights Act.

The substance of appellees' complaint is precisely the same as the complaint upheld in *Douglas v. Jeannette*, 319 U.S. 157. "In substance," the Supreme Court said,

the complaint alleges that respondents proceeding under the challenged ordinance, by arrest, detention and by criminal prosecutions of petitioners and other Jehovah's Witnesses, had subjected them to deprivation of

their rights of freedom of speech, press and religion secured by the Constitution, and the complaint seeks equitable relief from such deprivation in the future. . .

As to jurisdiction, the court said:

“We think it plain that the district court had jurisdiction as a federal court to hear and decide the question of the constitutional validity of the ordinance. . .

. . . the district courts of the United States are given jurisdiction by 28 U.S.C. Section 41 (14) over suits brought under the Civil Rights Act without jurisdictional amount. Not only do petitioners allege that the present suit was brought under the Civil Rights Act, but their allegations plainly set out an infringement of its provisions.

In effect appellants make the astounding assertion that a person shows no deprivation of the right of free speech by showing arrest and prosecution under a statute which abridges that right. According to this logic a member of the Jehovah's Witnesses sect could not complain of a deprivation of his right to distribute religious literature if in the course of distributing the literature he was guilty of an assault because he forced the door open against the householder's will. That he might be liable to prosecution for such an assault does not mean that he can be prosecuted under a statute which abridges freedom of worship.

A person has a right not to be arrested and prosecuted under laws that abridge freedom of speech; arrest and prosecution under such a void law constitutes a deprivation of a constitutional right, and he is deprived under color of law because the arresting officer acted by virtue of the authority the law purported to give him. Thus all the elements appellants say are necessary are present if the law complained of is unconstitutional.

Appellants have mesmerized themselves with their repeated assertions that the appellees seek only the right to violence and lawless conduct. Their state of mind under-

mines their legal scholarship. Even if it be assumed that some of the individual appellees are subject to prosecution under some valid law of the Territory, they are deprived of rights by being prosecuted under an invalid one.

Of course appellants' own witnesses refute the charge "deliberate use of mass force and violence" which they reiterate in defense of their conduct. It is a far cry from an incident at which nothing serious occurred, and as a result of which four or five persons might be charged with loitering, to the prosecution of eighty persons for a serious felony with a maximum of twenty years imprisonment.

Appellees' complaint not only raises the question of appellees' right to be free from intimidation and coercion in its exercise of the right to free speech, assembly and peaceful picketing by virtue of the void statutes. It also raises the question of the denial of equal protection implicit in having invoked against appellees statutes interfering with this right not invoked against other members of the community.⁸

The complaint further charges the misuse of power by appellants under color of law, that is, prosecutions not in good faith. Appellants' assertion to the contrary is surprising in view of the record. (B. 15-17) See *United States v. Classic*, 313 U.S. 299; *Screws v. United States*, 325 U.S. 91.

Thus, the complaint as amended (R. 3, 31) charges that the appellant Lane and his officers and agents charged appellees with

purported violations of said unlawful assembly and riot act;

that appellants Ackerman, Bevins and Crockett sought to present

⁸ Appellants devote Section V (B. 75-82) of their brief to establish that appellees suffered no denial of equal protection of the law. Appellees agree that the equal protection clause of the Fourteenth Amendment does not apply to Hawaii. Appellees agree also that the due process clause of the Fifth Amendment protects them against discriminatory action by either legislative or administrative action. Equal protection and rights under the law is also accorded appellees by Section 41 of Title 8, Civil Rights Act.

purported criminal charges for purported violations of the unlawful assembly act;

and that unless restrained, appellants will indict and place appellees on trial for alleged violations of said unlawful assembly and riot statute, and

will purport to act under color of said statute.

“Purported” means under “the specious and deceptive appearance of intending or claiming.” “Under color of” means “under pretense of.” *Screws v. United States*, 325 U.S. 91.

Appellants understood that the question of bad faith was an issue, and undertook to refute the evidence of bad faith adduced by the appellees. In appellants’ closing argument before the District Court, Miss Lewis stated:

. . . Apparently there is some attempt to persuade the court that the defendants in this case, the prosecuting officers, are not proceeding in good faith; that they do not have the facts to back up these charges. Well, we have been in here and we submit we have shown probable cause for each and every charge sufficient that a jury should decide the conflicts in the testimony. Hence, why go into the questions of bad faith? Well, the plaintiffs will say: “Maybe in those cases it is one thing, but how do we know what you will do in the future?”

and again, Miss Lewis stated:

. . . and we have some claim of bad faith which is met because we have shown what the proof is and what occurred, so that I think that redherring should be disregarded as well.

If misuse of power, that is, bad faith, will sustain a criminal charge under the Civil Rights Act, it cannot be disputed that bad faith is an element to be considered in a civil suit for deprivation of rights.

Denial of equal protection of the law is a deprivation of rights, which appellees showed. The evidence shows the repeated purposeful invocation of these two void laws for comparatively minor infractions of the law by appellants against the appellees.

The evidence also shows a general picture of the continuous selection of these laws for prosecution in cases growing out of labor disputes where its use seems inappropriate.

Appellants, by way of testimony introduced into the brief, cite a shocking case, uncovered since the hearing, of fifteen young men who, on a plea of guilty, were convicted under the unlawful assembly act where no labor dispute was involved. This case proves that the law is a danger, as the District Court said, to others in the community as well as laborers.

One such instance of the use of the statute under inappropriate conditions where a labor dispute is not involved, is scarcely enough to balance the scales which the statute has caused to be weighted so heavily against labor.

Appellees' Memorandum on Labor and the Law, Appendix I, shows the consistent and successful use of both these statutes in labor disputes for almost the full hundred years of their existence.

The record shows that the 1946 sugar strike was the first successful strike in the history of the Territory. The conclusion from the cases reported in appendix I is that the abuse of these criminal statutes played a substantial role in breaking the past strikes. See *Territory v. Soga*, 20 Haw. 71.

The removal cases cited by appellants (B., p. 51) are not applicable as tests of jurisdiction or quantum or nature of evidence under the Civil Rights Act. Thus, in *Screws v. United States*, the Supreme Court said:

Nor are the decisions under Section 33 of the Judicial Code, 28 U.S.C.A. Section 76, 7 F.C.A. Title 28, Section 76, in point. That section gives the right of re-

removal to a federal court of any criminal prosecution begun in a state court against a revenue officer of the United States "on account of any act done under color of his office or of any such revenue law." The cases under it recognize that it is an "exceptional" procedure which wrests from state courts the power to try offenses against their own laws, citing cases. Thus the requirements of the showing necessary for removal are strict. See *Maryland v. Soper* (No. 2), 270 U.S. 36, 42, 70 L. ed. 459, 461, 46 S. Ct. 192, saying that acts "necessary to make the enforcement effective" are done under "color of law." Hence those cases do not supply an authoritative guide to the problems under section 20 which seek to afford protection against officers who possess authority to act and who exercise their powers in such a way as to deprive a person of rights secured to him by the Constitution or laws of the United States. *It is one thing to deprive state courts of their authority to enforce their own laws. It is quite another to emasculate an Act of Congress designed to secure individuals their constitutional rights by finely spun distinctions concerning the precise scope of the authority of officers of the law. Cf. Yick Wo. v. Hopkins*, 118 U.S. 356, 30 L. ed. 220, 6 S. Ct. 1064. (Italics supplied.)

Jurisdiction of the person and subject matter of the complaint indisputably exists under the *Hague* and *Jeannette* cases.

Appellee made out a case in equity, as the District Court found under Section 1343 of the new Judicial Code and the Civil Rights Act. Appellees' showing that the statutes are unconstitutional, that appellees have been deprived of rights under them, have been singled out for harsher treatment than other members of the community, have been prosecuted in bad faith and denied equal protection of the laws, a fair and impartial jury, and that the fear engendered by the statutes weakens, disrupts and threatens labor relations, meets all the tests ever exacted to invoke the exercise of equitable discretion.

2. Existence of Jurisdiction Under Section 1337 of Title 28 of the New Judicial Code.

The District Court also found jurisdiction existed under Section 1337 of Title 28 of the new Judicial Code, formerly Section 24 (8), 28 U.S.C.A. 41 (8), (R. 430-439, R. 477-484). This holding was based upon the showing of the impact of both the unlawful assembly and riot act and the conspiracy act, and the manner of their enforcement by appellants on labor relations in Hawaii.

Clearly, the gist of the appellees' complaint was the threat to the effectiveness and the very existence of the union implicit in such sweeping, all-embrasive statutes, and the manner in which they were used by the appellants.

Thus, the appellee union and its two officers in representative capacities on behalf of all the members of the union, brought the suit "in order to protect and obtain the benefits of the Civil Rights Act and the Constitution of the United States for its members". The complaint alleged that in the course of labor disputes, the appellees engaged in lawful, peaceful and constitutionally protected activities of free speech, press and assemblage and of peaceful picketing; that the individual appellees were arrested under color or pretense of these void laws and charged by appellants with purported violations of these laws; that appellants sought to present or presented these charges to a grand jury illegally composed under federal and territorial laws; that unless appellants are restrained, appellees will be deprived of rights secured to them by the Constitution; that the appellees have spent thousands of dollars in the organization and establishment of a trade union, which cannot function and exercise its property rights and personal rights so long as its members are subject to indictment by an illegally constituted grand jury and subject to prosecution under statutes containing unconstitutional limitations on the right to picket because of the fear and intimidation of the appellees engendered by the threat of punishment for the exercise of

these rights guaranteed by the Constitution. (R. 3-20, 31-33; 12,301, 4-27)

Not only appellees' complaint but all the evidence of appellees showed the devastating effect of these laws and their impact upon labor relations.

In *American Federation of Labor v. Watson*, 327 U.S. 582, where suit was brought alleging a deprivation of rights because of a conflict with a provision of the Florida Constitution with rights under the First and Fifth Amendments and the National Labor Relations Act, a three-judge federal court found jurisdiction under Section 24 (1) and 24 (14) of the old Judicial Code. The Supreme Court, however, did not pass on the existence of jurisdiction under these provisions of the code but based jurisdiction on Section 24 (8), the predecessor of 1337.

Appellees here did not allege jurisdiction under Section 24 (8) of the old Judicial Code nor conflict with the National Labor Relations Act. The identity of the rights of association under the First Amendment and that Act appears in *National Labor Relations Board v. Jones & Laughlin Steel Company*, 301 U.S. 1. The complaints set forth and the evidence fully supports the District Court's finding of jurisdiction and of facts supporting that jurisdiction.

Appellants misapprehend the law when they assert that the District Court was without power to base jurisdiction on 1337 because the complaint did not allege jurisdiction under this section.

Rule 15 (b) of the Federal Rules of Civil Procedure allows amendments to conform to the evidence even after judgment.

The federal rule covering amendments is to be liberally construed, and should be allowed where the interests of justice will be served. An amendment which makes no change in the facts relied upon for recovery, but which merely alters the remedy or result of the facts alleged, it has been held, states no different cause of action and is proper.

Amendments may be made at any time while the court has jurisdiction, even after judgment; and *upon appeal* the appellate court *may regard a pleading as having been amended to conform to the proof*. These principles are well established. *McAllister v. Sloan*, 81 F. (2d) 707. In that case, it appeared that the plaintiffs, in drawing their complaint, proceeded on a theory of recovery under a statute, but stated sufficient facts to make out a cause of action at common law. The court's opinion contains an exhaustive summary of authorities:

. . . The practice of the federal courts is to permit amendments in all judicial proceedings where they are necessary to enable parties to reach the merits of the controversy they attempt to present, and where the allowance of the amendments will work no injustice. *In re Plymouth Cordage Co. et al.* (C.C.A.) 135 F. 1000, 1003; *Woodard v. Outland*, *supra*, 37 F. (2d) 87, 89. Amendments to pleadings are freely allowed where they are in furtherance of justice. The propriety of such amendments is a matter of discretion with the trial court, and its determination will not be disturbed unless it appears that its discretion has been unwisely exercised and that its action was not, under the circumstances, in furtherance of, but a detriment to justice. *Schulenberg v. Norton*, (C.C.A. 8) 49 F. (2d) 578, 579. Amendments may be made at any time while the court has jurisdiction, even after judgment; and upon appeal *the appellate court may regard a pleading as having been amended to conform to the proof*. *Schulenberg v. Norton*, *supra*, 49 F. (2d) 578, at page 579. An amendment which makes no change in the facts relied upon for recovery, but which merely alters the remedy or result of the facts alleged, states no different cause of action and is proper. *Schulenberg v. Norton*, *supra*, 49 F. (2d) 578, at page 579; *Missouri, Kansas & Texas Ry. Co. v. Wulf*, 226 U.S. 570, 33 S. Ct. 135, 57 L. Ed. 355; *New York Central & Hudson River R. Co. v. Kinney*, 260 U.S. 340, 43 S. Ct. 122, 67 L. Ed. 294; *Manhattan Oil Co. et al. v. Mosby* (C.C.A. 8) 72 F. (2d) 840, 843. (Italics supplied.)

The authorities amply support the power of the District Court to give judgment in accordance with the facts.

3. Jurisdiction Under Section 1331 of Title 28 of the New Judicial Code.

Appellants' statement of the court's finding of jurisdiction is confusing (B. p. 45). The court's ruling that jurisdiction existed without regard to jurisdictional amount under Section 1343 and 1337 applies to the union appellee as well as to the individual appellees. The findings as to the jurisdictional amount in notes 1 (R. 371) and 5 (R. 377-378) were alternative findings in event the reviewing court disagreed with the District Court's conclusion that jurisdiction existed under Section 1343 and 1337 of the new code.

The amended complaint in 12,300 (R. 2-24, 31-34) and the complaint in 12,301 (R. 2-27) allege that the case or controversy exceeds as to each plaintiff the sum of \$3,000. Appellants denied this.

The District Court found that the union appellee had established the jurisdictional amount, but that the damages to the individual appellees were not cognizable in monetary terms.

If this Court finds that jurisdiction as to the union appellee cannot be founded on 1343, jurisdiction has been established under 1331 of the Revised Code, 24 (1) of the old code.

There is no question as to the individual appellees' right under Section 1343.

Section 1359 of Title 28 of the new Judicial Code cited by appellants (B., p. 46) can have no conceivable application since it deals with collusive joinder of plaintiffs.

C. The District Court Had Jurisdiction to Hear and Determine the Case, Notwithstanding the Provisions of Section 2283 of Title 28 of the New Judicial Code and Section 265 of the Old Judicial Code.

The District Court held that Section 2283 of the new Judicial Code, Section 265 of the old Judicial Code, do not

deprive federal courts of jurisdiction to enjoin proceedings in state courts. (R. 469-472)

Both appellants and the Bar Association take the position that Section 2283 of the new Judicial Code deprives the District Courts of jurisdiction, that is *power*, to enjoin the enforcement of the statutes declared void and the threatened action of appellants in presenting charges to the grand jury under these statutes in 12,300 and to enjoin proceedings against the individual appellees in 12,301 under the indictment under these void statutes returned by the unconstitutionally composed grand jury.

The Bar Association brief states:

A United States District Court may not enjoin criminal proceedings pending in state courts because of congressional prohibitions against such intervention. This is so, irrespective of the circumstances surrounding the state court criminal proceedings, the methods or motives of state prosecuting officers, or any other factors. (p. 4)

Appellants submit, by reason of the prohibition of Section 2283,

that a federal equity court cannot enjoin pending state or territorial criminal prosecutions, that it lacks jurisdiction to do so. (B. p. 40)

These are remarkable statements in the light of history.

Section 265 of the old Judicial Code has long been held to be a rule of comity. In an article entitled "The Power of Federal Courts to Enjoin Proceedings in State Courts," 42 Yale Law Journal 1168, at page 1172, it is stated:

The Supreme Court has flatly declared that Section 265 is not a limitation upon the jurisdiction of the federal courts, but is merely a restriction upon the exercise of their power to grant equitable relief. This constitutes an open avowal that even though the sole object of a federal suit is to enjoin proceedings in a state court, the

federal court must nevertheless inquire into the merits of the controversy and determine whether or not the relief should be granted.

Smith v. Apple, 264 U.S. 274. Accord: *Sovereign Camp Woodmen of the World v. O'Neill*, 266 U.S. 292; see *Russell v. Detrick*, 23 F. 2d 175, 178 (C.C.A. 9th, 1927).

Curiously, the Bar Association, in note 7 at page 37 of its Brief, exposes the speciousness of the argument, made as a flat assertion, that Section 265 of the old Judicial Code is jurisdictional and not a rule of comity as construed by the Supreme Court. In that note, it is pointed out that an unsuccessful attempt was made in Congress in 1910 to deprive federal courts of the jurisdiction they had asserted and exercised for over 100 years to enjoin the enforcement of state statutes. Instead, the existing judicial construction was legislatively sanctioned, but with new procedural requirements. To guard against the improvident issuing of injunctions against the "enforcement, operation or execution" of state statutes, the three-judge court requirement was adopted. This provision did not, of course, enlarge equity jurisdiction, but neither did it narrow it. The words "enforcement, operation or execution" of statutes comprehends criminal as well as civil statutes and proceedings.

The position of appellants and the Bar Association is particularly remarkable in the light of *Hague v. CIO*, 307 U.S. 496, *Bevins v. Prindable*, 39 F. Supp. 708, affirmed, 314 U.S. 573, and *Douglas v. Jeannette*, 319 U.S. 157, which hold that Section 43 of Title 8 gives federal district courts jurisdiction of suits in equity to restrain state officers, acting under color of state laws, from infringing on rights guaranteed by the Constitution and federal law.

In *Hague v. CIO*, 307 U.S. 496, Mr. Justice Stone stated:

. . . the right to maintain a suit in equity to restrain state officers, acting under a state law, from infringing the rights of freedom of speech and assembly guaran-

teed by the due process clause, is given by Act of Congress to every person within the jurisdiction of the United States whether a citizen or not, and such a suit may be maintained in the district court without allegation or proof that the jurisdictional amount required by Section 24 (1) of the Judicial Code is involved.

Whether the court should exercise its discretion to grant the relief prayed depends on whether the petitioner establishes a cause of action in equity. But there is no artificial distinction to be made between state officers threatening to act under color of law, and state officers acting under color of law.

In *Douglas v. Jeannette*, 319 U.S. 157, Mr. Justice Stone, writing for the majority, said:

... the arrest by the federal courts of the processes of the criminal law within the states, and the determination of questions of criminal liability under state law by a federal court of equity, are to be supported only on a showing of danger of irreparable injury "both great and immediate."

To make out their theory that federal district courts have no jurisdiction to stay state court proceedings under criminal laws in violation of the federal Constitution, appellants and the Bar Association have to play hopscotch through the cases. It is clear that they jumped all the cases decided under the Civil Rights Act on which appellees' suit is based.

After noting exceptions engrafted on what they contend is the statutory prohibition by judicial decision and statute, both appellants and the Bar Association buttress their contention that the statute removes jurisdiction from federal district courts to enjoin civil and criminal proceedings in state courts by what they describe as the doctrine of *Cline v. Frink Dairy Co.*, 274 U.S. 445, and *Ex Parte Young*, 209 U.S. 123.

In the *Cline* case, a federal three-judge court held unconstitutional a state anti-trust law and restrained its enforce-

ment both in pending and threatened prosecutions. The Supreme Court held that a case for the exercise of equitable jurisdiction had been made out and that the statute was unconstitutional. It modified the injunction in so far as it was directed against the pending prosecutions.

Appellants seek to prove too much. First, clearly if the Supreme Court of the United States, or a federal district, or circuit court, declared a state criminal statute unconstitutional on its face and restrained its enforcement, it would be a fool-hardy state prosecutor indeed who would attempt thereafter to procure convictions in pending prosecutions under the voided statute. In fact, the court in the *Cline* case noted that the objection would lead only to a narrowing of the decree.

The voiding of the statute and the restraining of its enforcement accomplishes the purpose. In *Hague v. CIO*, the court said:

As the ordinance is void, the respondents are entitled to a decree so declaring and an injunction against its enforcement by the petitioners.

In *Douglas v. Jeannette*, the court, referring to its decision of the same day in the *Murdock* case declaring the challenged ordinance void, said:

There is no allegation and no proof that respondents would not, nor can we assume they will not acquiesce in the decision of this court holding the challenged ordinance unconstitutional as applied to petitioners.

Second, it appears from the *Cline* case that the plaintiff complained to the federal court that the state officers threatened to and were about to present evidence to the grand jury to procure indictments under the void statute.

This is exactly what the appellees complain of in case No. 12,300. Prosecution of these appellees could only be by indictment under the requirements of the Fifth Amend-

ment. After the District Court had assumed jurisdiction in 12,300 and issued a restraining order based on the substantial showing of the unconstitutionality of the statute and the illegality of the method of selection of the grand jury against the appellants Crockett and Bevins and the grand jurors, and while they were so restrained, the indictment against the individual appellees in 12,301 was returned under the challenged statute by the challenged grand jury. It is noteworthy that the appellees in 12,300 were before the court as members of the class represented by the union and Kawano in his representative capacity for all the members of the union.

It is rather difficult to square this with the principles of comity.

Thus, under the doctrine of the *Cline* case, the District Court, having acquired jurisdiction of the litigants and the subject matter, could stay the proceedings to protect its own jurisdiction previously acquired. *Ex Parte Young*, 209 U.S. 123.

Third, it is also noteworthy that in the *Cline* case both the three-judge court and the United States Supreme Court, finding the challenged statute unconstitutional on its face, and a cause of action in equity made out, saw no necessity for awaiting an authoritative construction of the statute in the pending prosecution in the state court.

The decrees in these cases declare the statutes void and restrain their enforcement against the individual appellees, and through the union appellee and the class representatives, all the members of the union under any complaint or indictment based on the laws declared void.

Appellants' assertion that the District Court "seems to have been of the view that the bringing of the present cases under the Civil Rights Act enlarged the scope of its equity jurisdiction" (R. 480) is unwarranted and unsubstantiated by anything the court said. The only meaning that can be ascribed to this assertion is that appellants disagree with the

court that good faith is material under the Civil Rights Act.

In both *Hague v. CIO* and *Douglas v. Jeannette*, the Supreme Court made no specific reference to Section 265 of the old code. In both cases it cited Section 43 of Title 8 as the statutory base for the maintenance of the suit.

Appellees have no quarrel with the assertion that the Civil Rights Act did not enlarge equity jurisdiction of the federal court, but it clearly gave federal district courts jurisdiction in law and equity of causes of action within its scope.

Appellants seem to feel that since Section 265 of the old Judicial Code was adopted in 1793 it thereupon modified existing standards of a cause of action in equity. The logic is the other way.

The fact that the Civil Rights Act was adopted after the code section indicated an intention to engraft a statutory exception to Section 265 where a cause of action in equity was made out. As we have seen, this is the construction that the Supreme Court has given the Civil Rights Act.

Appellants assert that the lower court held that a bill in equity confers greater powers of intervention in pending state criminal cases for the protection of civil rights than does the removal statute, "it being only necessary, according to this holding, that petitioner ignore the ancillary nature of such an equity bill, whereupon the federal court will find itself free of all statutory limitations." (B., 90-91)

Perhaps losing litigants, like poets, having a certain license. If such license exists, it has been stretched pretty far here.

The District Court stated that it was of the opinion that decisions controlling the removal of civil rights cases to the federal courts are not persuasive in these cases.

The question presented, the court said, is not whether the case of *Territory v. Kaholokula* may be removed to the federal court, but whether, in a suit based upon the Civil Rights Acts, this court may consider whether appellees have been deprived of rights guaranteed to them by the Consti-

tution of the United States by reason of the methods employed in the selection of the 1947 Maui County Grand Jury.

That the removal statutes are not an "authoritative guide to the problems under section 20 which seeks to afford protection against officers who possess authority to act and who exercise their powers in such a way as to deprive a person of rights secured to him by the Constitution or laws of the United States," was specifically held in *Screws v. United States*, 325 U.S. 91.

Appellants also invoke habeas corpus proceedings to buttress their contention that the District Court committed "error of the first magnitude" in giving "unlimited scope to a non-existent equity power of intervention expressly prohibited to be used."

But in habeas corpus proceedings, as in suits in equity under the Civil Rights Act, there can be no question of the power of the federal courts to act, and their discretion is based on the circumstances of the case. This was made very clear by the Supreme Court in *Ex Parte Royall*, 117 U.S. 241, in which it was held that federal courts have jurisdiction to discharge on habeas corpus before trial a person who is restrained of his liberty in violation of the Constitution of the United States, and who is held under state process for trial on an indictment charging him with an offense against the laws of the State. Because of the facts in the case, the Supreme Court did not reverse the denial of the writ, but qualified the discretionary power of the lower court, saying:

The circuit court has a discretion whether it will discharge him upon habeas corpus in advance of his trial in the court in which he is indicted; *that discretion, however, to be subordinated to any special circumstances requiring immediate action.* (Italics ours.)

In suits in equity to redress deprivation of constitutional rights, like in habeas corpus proceedings, the question is

not of the jurisdiction of the federal court, but whether a case is made out in which the equitable jurisdiction should be exercised as a matter of discretion.

Beal v. Missouri Pacific R. Corp., 312 U.S. 45, 85 L. ed. 577, decided in 1940, fourteen years after the *Cline* case, states the rule:

Interference with the processes of the criminal law in state courts, in whose control they are lodged by the Constitution, and the determination of questions of criminal liability under state law by federal courts of equity can be justified only in most exceptional circumstances, and upon clear showing that an injunction is necessary in order to prevent irreparable injury.

This rule was cited and confirmed in *Watson v. Buck*, 313 U.S. 387, 85 L. ed. 1417, by the Supreme Court and again in affirming *Bevins v. Prindable*, 39 F. Supp. 708, at 314 U.S. 573.

Section 2283 does not oust federal courts of jurisdiction in suits to grant injunctive relief against criminal proceedings in a state court. Under the Civil Rights Act, the federal courts are given jurisdiction to redress deprivation of constitutional and federal rights and are bound to grant relief if a showing is made that a state officer acting under color of law deprives a person of rights and exceptional circumstances exist and a showing of irreparable injury is made. Failure to exercise discretion in a proper case is reversible error. *AFL v. Watson*, 327 U.S. 582, *Toomer v. Witsell*, 334 U.S. 385.

D. The Union and Class Representatives Are Proper Parties.

The District Court considered the appellants' contentions that the union and class representatives are not proper parties at all stages of the proceedings, and overruled the objections. It held that the union and class representatives are proper parties by direct holding of the Supreme Court in

American Federation of Labor v. Watson, 327 U.S. 582. (R. 513-515.) Both *Douglas v. Jeannette* and *Bevins v. Prindable*, where the jurisdiction of the court over the cause of action and the parties was upheld, were class suits.

Appellants' contention with respect to *Hague v. CIO* has already been discussed, *supra*, pages 28-29. See also *Stapleton v. Mitchell*, 60 F. Supp. 51.

An unincorporated association is nothing more in contemplation of law than the individuals who compose it.

Appellees showed the impact of the actions of appellants on every phase of its activities, and the fear and intimidation of its members resulting from the actions under color of these two statutes of appellants.

At the instance of the appellant Attorney General, the Legislature of the Territory of Hawaii in 1949, after the decision and decrees of the court, repealed both the unlawful assembly act and the conspiracy act declared void by the court, and substituted new laws, except as to the 127 individual appellees against whom the Territorial Legislature attempted to preserve the right to proceed with prosecutions, even though motivation for the repeal was the declared unconstitutionality of the statutes by the three-judge court.⁹

It was noted by both the House and Senate reports that the penalty was excessive. This was conceded before both Houses by the appellant Attorney General.

⁹ A bitter fight developed in the House of Representatives on the attempt to re-enact the unlawful assembly and riot act declared unconstitutional by the court. The Minority Report of the House Judiciary Committee is set forth in Appendix II. The vote on the Bill in the House was 19-10 for enactment.

The unlawful assembly act as it existed at the time of the court's decision is set forth in full in Appendix I of the Appellants' Opening Brief, pp. 188-192. The Repealing Act and the new text is set forth in Appendix III of Appellants' Opening Brief, pp. 192-195. The Conspiracy Statute, as it existed at the time of the court's decision, appears in Appendix IV, pp. 195-198 of Appellants' Brief, and the repealing and amending act is set forth in Appendix V, pp. 198-200.

That the re-enactment of these two statutes was at the instance of the appellant Attorney General appears from the Majority Report of the House Judiciary Committee:

This bill is an administration bill prepared and drafted by the Office of the Attorney General of the Territory of Hawaii. The purpose of this bill is to re-define the crime of "riot" by increasing the number necessary to constitute a riot from "three or more" persons to "six or more" persons; to decrease the penalty therefor from "twenty" years to "two" years; to amend Section 11581 of the Revised Laws of Hawaii 1945 and making it a misdemeanor to remain present at a place of riot after being ordered to disperse; and to repeal the remaining sections of Chapter 277.

The fact that only members of the appellee union can be prosecuted under the two void acts, increases rather than diminishes the threat of irreparable injury to the appellees.

There can be no question that a justiciable controversy exists. The right to be free from prosecution under color of territorial law of statutes infringing on constitutional rights, and to equal protection of the laws is the right of every person.

Even apart from the threat to appellees from the enforcement of the statutes, the right to a representative grand jury selected in accordance with constitutional standards is the right of every person. The denial of this right is in and of itself a denial of the equal protection of the laws. *Neal v. Delaware*, 103 U.S. 370; *Smith v. Mississippi*, 162 U.S. 592.

E. The Doctrine of Clean Hands Has No Application to These Cases.

Appellants assert that this equity maxim is applicable here, and that the court misunderstood the maxim. (B. 100-103)

The court discusses the question fully in its decision, and holds the doctrine inapplicable. (R. 485-486)

As we have seen, appellants' witness, Assistant Chief of Police Freitas, testified that he stated in his official report that nothing serious occurred during the Paia incident; that possibly four or five persons might be charged to make a test case out of the loitering law. He told the picketers at the time that if any breaches of the peace occurred, arrests would be made. Twenty police officers were present and no arrests were made.

Yet, 79 persons were subsequently indicted under the 20-year felony statute in the first indictment, and 75 persons were charged under both statutes in the second indictment.

In the recent case of *Toomer v. Witsell*, 73 F. Supp. 371, 334 U.S. 385, the question of the application of the maxim to a suit for equitable relief against an allegedly unconstitutional statute was considered.

The specially constituted three-judge court said:

Defendants point to the fact that certain of plaintiffs have been found guilty of criminal violation of the statutes and say that in proper application of the clean hands doctrine they should not be heard by a court of equity. It is well settled, however, that courts of equity "do not close their doors because of plaintiff's misconduct, whatever its character, that has no relation to anything involved in the suit, but only for such violations of conscience as in some measure affect the equitable relations between the parties in respect of something brought before the court for adjudication. Story, *id.*, § 100. Pomeroy, *id.*, § 399. They apply the maxim, not by way of punishment for extraneous transgressions, but upon considerations that make for the advancement of right and justice. They are not bound by formula or restrained by any limitation that tends to trammel the free and just exercise of discretion." *Keystone Driller Co. v. General Excavator Co.*, 290 U.S. 240, 245, 246, 54 S. Ct. 146, 147, 78 L. Ed. 293; *Mas v. Coca Cola Co.*, 4 Cir., 163 F. 2d 505. The matter involved in suit here is the constitutionality of the statutes complained of by plaintiffs, and neither this

question nor the equitable relationship of the parties could possibly be affected by plaintiffs' disobedience of the statutes; and, at all events, the matter is one resting in our discretion and we should not exercise that discretion to refuse a hearing to one who complains that state legislation affecting others as well as himself is violative of rights guaranteed by the Constitution of the United States.

The Supreme Court affirmed this decision, saying:

Some of the individual appellants had previously been convicted of shrimping out of season and in inland waters. The District Court held that this previous misconduct, not having any relation to the constitutionality of the challenged statutes, did not call for application of the clean hands maxim. We agree.

Appellants assert flatly that the court has no power to look to their bad faith, but yet insist that because some infractions of the law occurred, they can with impunity violate and deprive appellees of their constitutional rights.

F. Bad Faith of the Prosecutions Was Properly Considered by the District Court as an Element of Appellees' Showing of Exceptional Circumstances and Irreparable Injury. (B. 103-134, amicus brief 40-49.)

Appellants advance the novel contention that the opposite of good faith prosecution is not prosecution in bad faith, and that a federal court cannot interfere with the exercise of power by state law enforcement officers. (B., pp. 103-109.)

Again appellants seek to invoke the removal cases to support their contention. As we have shown, they are inapplicable in suits to redress deprivation of rights under color of law. Action in abuse of power held because an officer is clothed with the authority of the law makes the plainest case of violation of civil rights.

The District Court came to the conclusion that the action taken by appellants was not in good faith. (R. 480-483.) Its

findings are amply supported by the record. Its conclusion is supported by the Supreme Court decisions under the Civil Rights Acts.

In *United States v. Classic*, 313 U.S. 299, the court said:

Misuse of power possessed by virtue of state law and made possible only because the wrongdoer is clothed with the authority of state law, is action taken under color of law.

The Civil Rights Act provides both civil redress and criminal sanctions against action of state officers under color of law. The criminal counterpart of Section 43 is Section 20 of the old criminal code. Section 242 of Title 18 provides:

Deprivation of rights under color of law

Whoever, under color of any law, statute, ordinance, regulation, or custom, willfully subjects any inhabitant of any State, Territory, or District to the deprivation of any rights, privileges, or immunities secured or protected by the Constitution or laws of the United States, or to different punishments, pains, or penalties, on account of such inhabitant being an alien, or by reason of his color, or race, than are prescribed for the punishments of citizens, shall be fined not more than \$1,000 or imprisoned not more than one year, or both.

In construing this section, which is dealing in *pari materia* with Section 43 of Title 8, in *Screws v. United States*, 325 U.S. 91, the court said:

Acts of officers who undertake to perform their official duties are included whether they hew to the line of their authority or overstep it. If, as suggested, the statute was designed to embrace only action which the State in fact authorized, the words "under color of any law" were hardly apt words to express the idea.

After rejecting the tests of the removal statute as a guide to the interpretation of Section 20, the court continued.

Hence those cases do not supply an authoritative guide to the problems under § 20 which seeks to afford protection against officers who possess authority to act and who exercise their powers in such a way as to deprive a person of rights secured to him by the Constitution or laws of the United States. It is one thing to deprive state courts of their authority to enforce their own laws. It is quite another to emasculate an Act of Congress designed to secure individuals their constitutional rights by finely spun distinctions concerning the precise scope of the authority of officers of the law.

It is clear that all of the actions found by the court in support of its conclusion that the prosecutions against appellees by appellants were not in good faith are actions taken under color of law and in abuse of law. The District Court's refusal to dismiss as to appellants Bevins and Crockett after they ceased to hold office was therefore proper.

This was the very purpose for which Section 43 was designed—to provide redress for persons deprived of rights secured by the Constitution or laws of the United States.

It is the duty of a federal court to see that federal rights are protected in substance as well as in form. In *Norris v. Alabama*, 294 U.S. 587, the Supreme Court said:

When a federal right has been specially set up and claimed in a state court it is our province to inquire not whether it was denied in express terms, but also whether it was denied in substance and effect.

Surely a federal court has the same duty when it is the trier of facts.

In *Yick Wo v. Hopkins*, 118 U.S. 356, the Supreme Court made it clear that there is no room in our constitutional government for purely arbitrary and personal power. The court said:

When we consider the nature and theory of our institutions of government, the principles upon which they are supposed to rest, and review the history of

their development, we are constrained to conclude that they do not mean to leave room for the play and action of purely personal and arbitrary power.

The petitioner was discharged on a writ of habeas corpus from imprisonment under a state law held to be valid and which appeared on its face to be valid. As enforced, however, it was directed against only persons of one group or class—Chinese subjects.

The court held:

In the present cases, we are not obliged to reason from the probable to the actual and pass upon the validity of the ordinances complained of, as tried merely by the opportunities which their terms afford, of unequal and unjust discrimination in their administration. For the cases present the ordinances in actual operation, and the facts shown establish an administration directed so exclusively against a particular class of persons as to warrant and require the conclusion that whatever may have been the intent of the ordinances as adopted, they are applied by the public authorities charged with their administration, and thus representing the State itself, with a mind so unequal and oppressive as to amount to a practical denial by the State of that equal protection of the laws which is secured to the petitioners, as to all other persons, by the broad and benign provisions of the Fourteenth Amendment to the Constitution of the United States. Though the law itself be fair on its face and impartial in appearance, yet, if it is applied and administered by public authority with an evil eye and an unequal hand, so as practically to make unjust and illegal discriminations between persons in similar circumstances, material to their rights, the denial of equal justice is still within the prohibition of the Constitution.

Appellants urge that the District Court is putting the people of Hawaii on trial. Appellees disagree.

Appellants are four law enforcement officers who have acted in abuse of the power they possessed by reason of their office.

Who are the *people* of Maui County—the 80% of laboring men who have been excluded from jury service, been singled out for harsh and abusive treatment by local law enforcement officers, and who are libeled and reviled with bitter hatred by appellants because they seek to secure the benefit of the United States Constitution for themselves and their fellows? Or the four appellants who, in their exercise of arbitrary power in defiance of the Constitution, attempt to wrap themselves in the sovereignty of the people?

The District Court's finding that the treatment accorded appellees was for the purpose of attack upon a labor movement is inescapable on the basis of the record before the court.

It is not the people of Hawaii who are impeached, but appellants; their conduct has impeached them.

The record of the abuse of law enforcement in Hawaii against labor from court cases is shown in Appendix I. How any fair-minded person could or would try to justify the outrages there apparent, and equally apparent in these cases, is difficult to understand.

Both the appellants and the Bar Association condone the practice of special prosecutors.

Private vengeance should have no place in the criminal law. The fiction of supervision indulged in by the Supreme Court of Hawaii is a sad substitute for impartiality in the administration of justice for the welfare of society rather than for private clients of an attorney in private practice.

A special prosecutor hired by the Hawaiian Sugar Planters' Association, *Territory v. Crowley*, 34 Haw. 774, sent a newspaper editor to jail for charging that a former general, hired by the H.S.P.A., deceived the Filipino workers and got them to call off their strike, and there would be peace, and then hired special prosecutors to secure convictions of the leaders.

The editorial charged in part:

General 'Blank' it was who, trading on his military title and prestige, made peace with the 4,500 Filipino workers on Maui two months ago.

Promised by him, say Filipino leaders, was end of HSPA war upon workers, end of court persecution.

Now, with open charges, undenied, that General 'Blank' lied and deceived workers who trusted to the honor of the U. S. Army, Maui is again on the verge of ferment.

Instead of peace, General 'Blank' swings the HSPA sword, hurls HSPA mercenaries into the court to convict the Filipino leaders.

And 60,000 Filipino workers cry out, send word to Manila, and all over their homeland, that America is a land of persecution, ruled by unprincipled and revengeful men.

Over all their homeland goes word that American generals are liars and deceivers, schemers to oppress and imprison Filipinos who are innocent.

The Maui case has been a disgrace to the people of Hawaii.

It has been a travesty on American justice, for in it public power has been seized and used ruthlessly for private terrorism and revenge.

It has been a shame to the Roosevelt administration through connivance for wrong by the highest governmental powers in the Territory, the governor and the attorney general of Hawaii.

It has been a signal to the Filipino people that their sons here will be victimized, abused, robbed of their rights and liberties under pretense of law and order.

A remarkable doctrine of criminal law was developed in this case: that the burden of proof rests on the defendant under Hawaii's criminal libel law.

Associate Justice Peters, dissenting, said:

Both defendants should be granted a new trial. The trial court committed reversible error by instructing

the jury as requested by the prosecutor that it was incumbent upon the defendants to prove justification by a preponderance of the evidence. . . . It is axiomatic that in a criminal case it is incumbent upon the prosecution to prove all of the essential ingredients of the offense charged beyond a reasonable doubt.

This practice of permitting private clients to have their lawyer serve as an advocate in a criminal trial is used and abused almost daily, particularly in the police courts where most defendants are not represented by counsel.

It is difficult to find a satisfactory rationale for the practice consistent with due process of law and a fair and impartial trial.

Appellants' Memorandum on Labor and the Law shows the almost invariable use of private-hired prosecutors in cases arising out of labor disputes prior to 1946. Since then, special deputy attorney generals have been hired by the Attorney General to prosecute charges of contempt of anti-picketing restraining orders, for the County of Kauai and the City and County of Honolulu.

Appellants engage in afterthoughts of evidence which, if true, should properly have been brought out on cross-examination in respect to the testimony of Jack W. Hall.

No one should know better than appellants that the pineapple strike was broken after five days, they deserve such a lion's share of the credit.

Appellants exclaim in italics that some of the arrests in the Lanai harbor incident were made more than two weeks after the pineapple strike was over, and therefore could not have affected the strike. Appellants forget the medium of the press: the machine guns, tear gas and riot squads brought with a fanfare of publicity. (See reference to Hilo riot squad, R. 1677.)

The background of the harbor incident carries a strong inference of an attempt to provoke the strikers:

1. The dispatching of a barge, ordinarily carrying 152 bins of pineapple, from Honolulu to load 11 crates of six-day old pineapple, when pineapple is shipped within 48 hours.

2. The strategic placing of three photographers.

3. The presence of company executives to perform the loading operations.

A thoughtful or planned course would have dictated that the most effective weapon for the strikers would have been for them to sit on the sea wall and laugh, while the company executives loaded the 11 bins of six-day old pineapple, fit only for waste products, worth less than the cost of transportation.

Likewise, at the trivial incident at Paia, it is difficult to deduce what five employees out of an ordinary force of 1,000 laborers could do in a closed sugar mill.

A sugar plantation with its thousands of acres bears little resemblance to a factory in a crowded industrial zone of a city. A company town bears little resemblance to an industrial city.

The employees of the company make up the population of the town. When the company is working, the life of the community revolves around the company. When the employees are striking, the life of the community revolves around the strike.

As a result of the Paia incident, 75 men were charged with the 20-year felony of unlawful assembly and riot as an aftermath of an incident during which no blows were struck, the police read the loitering law to the pickets, but did not order them to disperse, and no arrests were made, although 20 police officers were present. The whole trivial incident lasted less than three minutes.

The Kalua incident involves an assault and battery on 2 men, yet as a result of the incident, 5 men were charged with unlawful assembly.

The harbor incident, which lasted less than five minutes, resulted in at most two assault and batteries and in some pineapples being thrown out of bins.

Yet, as a result of these three incidents, 127 persons are faced with the felony of unlawful assembly and riot, loss of political rights and deportation for the non-citizens.

That the appellants do not in good faith believe that conviction under such charges are necessary to satisfy the ends of justice is proved by the Yamauchi incident, as a result of which 21 men were indicted for unlawful assembly and riot and conspiracy. After the strike was over, appellants nolle prossed the felony charges and fines were imposed on pleas of nolo contendere to assault and battery charges.

On the basis of these records, the invocation of a twenty-year felony statute is so obviously inappropriate that the conclusion that the prosecution was not for the ends of justice is inescapable.

In addition to the assault and battery statute and the affray statute, there are two territorial statutes, other than the unlawful assembly and riot act, which purport to authorize punishment for rioting and loitering: Section 11773, Revised Laws of Hawaii 1945, and Section 11771, Revised Laws of Hawaii 1945. The latter section provides that every person who is dangerous or disorderly by reason of being a rioter, disturber of the peace, going offensively armed, uttering menaces or threatening speeches or otherwise, is a vagrant and shall be punished by a fine of not less than ten dollars nor more than \$500, or by imprisonment for not more than one year, or by both such fine and imprisonment.

Thus the prosecuting officers and the grand juries, under existing statutes, can choose to charge rioters for exactly the same offense as a misdemeanor or a felony, leaving in their sole discretion which groups shall be singled out for harsh and discriminatory treatment.

The appellants seek to justify the practice of charging serious felonies on sworn complaint where no evidence ex-

isted at the time the complaint was sworn to; sworn complaints by an officer that over fifty persons were guilty of a serious felony when his official police report of the incident reports that nothing serious happened.

Appellants object to the finding of the court as to excessive bail. The amounts speak for themselves. It is to be noted also that \$1,000 bail was required of Awana in the Paia incident (R. 1281).

Appellants, grasping at any straw, assert that the fact that after the bank refused to cash the \$7,000 check of Mr. de la Cruz and that money was raised from businessmen undermines the court's findings as to the economic structure of Lanai.

Appellees' Appendix I shows the persistent and consistent use of the unlawful assembly and riot act and the conspiracy act in labor disputes for the 100 years of their existence.

The fact that after the hearing, appellants discovered that fifteen boys were convicted on a plea of guilty under an obviously inappropriate use of the statute scarcely overcomes the overwhelming evidence of its repeated and inappropriate selection as a vehicle for prosecution of minor infractions of the law in labor disputes.

Appellants characterize the haste with which the appellant Crockett procured the second indictment as a mere irregularity. Conveniently, no mention is made of the contemptuous conduct toward the District Court in procuring the indictment while under restraint in the companion case involving identical issues.

The District Court accepted the testimony of appellants' witness on all disputed facts. Its judgment is a considered ruling that, placing the construction on the facts most favorable to the appellants, the prosecutions were not in good faith.

II. THE UNLAWFUL ASSEMBLY AND RIOT ACT IS UNCONSTITUTIONAL ON ITS FACE AND AS EXTENDED IN SCOPE AND EFFECT BY THE DECISION OF THE SUPREME COURT OF THE TERRITORY OF HAWAII.

A. The Act is Unconstitutional on Its Face.

In *Watson v. Buck*, 313 U.S. 387, the Supreme Court stated that:

It is of course conceivable that a statute might be flagrantly and patently violative of express constitutional prohibitions in every clause, sentence and paragraph, and in whatever manner and against whomever an effort might be made to apply it.

The Unlawful Assembly and Riot Statute, Chapter 277, Revised Laws of Hawaii, repealed except as to the appellees in these cases, is such a statute.

Its counterpart has been specifically so declared by the United States Supreme Court. Its unconstitutionality is apparent by the standards laid down in all First Amendment cases. But the court in *Bridges v. California* struck this statute down as explicitly as words allow.

Of course, where a statute is unconstitutional on its face, it needs no construction.

Cline v. Frink Dairy Co., 274 U.S. 445.

Hague v. CIO, 307 U.S. 496.

Thornhill v. Alabama, 310 U.S. 88.

Toomer v. Witsell, 334 U.S. 385, 392, note 15.

The reason why a statute void on its face needs no construction was pungently explained in *Giles v. Harris*, 189 U. S. 475, 487, a suit in equity under the Civil Rights Act, where it was said:

If the sections of the constitution concerning registration were illegal in their inception, it would be a new doctrine in constitutional law that the original invalidity could be cured by an administration which defeated their intent.

In *Near v. Minnesota*, 283 U.S. 697, and *Grosjean v. American Press Co.*, 297 U.S. 233, the Supreme Court warned in clear and unequivocal language that the common law of England in respect to free speech, free thought, free assembly and religion was not ours and was specifically rejected by the framers of the First Amendment.

In *Cantwell v. Connecticut*, 310 U.S. 296, the Supreme Court struck down an application of the common law concept of breach of the peace as violative of free speech, saying:

To persuade others to his own point of view, the pleader, as we know, at times, resorts to exaggeration, to vilification of men who have been, or are, prominent in church or state, and even to false statement. But the people of this Nation have ordained in the light of history that in spite of the probability of excesses and abuses, these liberties are, in the long view, essential to enlightened opinion and right conduct on the part of the citizens of a democracy.

The first case to challenge directly the police power of the state to legislate to prevent riots and unlawful assemblies was *Hague v. CIO*, 307 U.S. 496. Although the court several years earlier in the *Davis* case had upheld the power of Massachusetts to prohibit if it saw fit assemblies on the Boston Common, in the *Hague* case the court held void on its face and restrained the enforcement of an ordinance of Jersey City which authorized the Director of Public Welfare to issue permits for meetings in parks although his power to deny permits was strictly limited to cases where he felt it necessary for the prevention of riots, disturbances and disorderly assemblies.

In *Bridges v. California*, 314 U.S. 252, the Supreme Court said in specific language, that the restrictions on assembly prevalent in England at the time of the adoption of the Bill of Rights, specifically, the Riot Act of George I, stat. 2., c. 5., were measures which the Constitution prohibited the American Congress from passing.

The full text of the territorial Unlawful Assembly and Riot Statute is set forth in the opinion of the District Court, and likewise the text of George the First's Riot Act.

The District Court discusses fully the provisions of both acts, and finds a startling resemblance between the two, with the scales weighted more heavily in favor of assembly in the Riot Act of George I than in the Act adopted in 1850 by the King-appointed House of Nobles and Representatives of the Kingdom of Hawaii.

The declaration of unconstitutionality by the court in the *Bridges* case could not be more clear and explicit. The court said:

In any event it need not detain us, for to assume that the English common law in this field became ours is to deny the generally accepted historical belief that 'one of the objects of the Revolution was to get rid of the English common law on liberty of speech and of the press.' (Citations.) . . .

No purpose in ratifying the Bill of Rights was clearer than that of securing for the people of the United States much greater freedom of religion, expression, assembly and petition than the people of Great Britain had ever enjoyed. It cannot be denied, for example, that the religious test oath or *the restrictions* upon assembly¹⁰ then prevalent in England would have been regarded as measures which the Constitution prohibited the American Congress from passing. . . .

So great was the danger from these laws that every vestige of popular liberty would have been destroyed, Buckle reports in his "History of Civilizations in England," referred to in the note in the *Bridges* case, but for "the bold spirit with which our English juries, by their hostile verdicts, resisted the proceedings of government, and refused to sanction laws which the crown had proposed, and to which a servile legislature had willingly consented."

¹⁰ Geo. I., stat. 2, c. 5, cf. also 36 Geo. III, c. 8, and discussion in I Buckle, *History of Civilization in England*, 351.

So armed with the supreme law of the land, the appellees at No. 12,301, after their challenge was overruled, went confidently to the Supreme Court of the Territory of Hawaii.

An interlocutory appeal is an extraordinary procedure and certainly one in which no lawyer would engage unless confident of a favorable outcome of the proceedings.

The federal law was clear and the history of the origin of the local statute made the outcome more clear.¹¹

The Unlawful Assembly and Riot Act and Peonage or Penal Labor Act were adopted the same year.

As appears from appellees' Memorandum of Labor and the Law, in 1890 there were 7,612 male contract laborers in Hawaii. During that year, there were 5,706 arrests for deserting servitude and 5,389 convictions.

The use of the unlawful assembly and conspiracy statute during this period is also described. Whenever disturbances occurred on plantations in protest over conditions and wages, the leaders were charged with riot. As a result of the disturbances some improvements in conditions were made, but the leaders of the "riots" were usually always deported to China.

It is clear, as the District Court holds, that the territorial statute places it within the power of the opponents to a meeting, or police who do not approve of the purpose of a meeting, to interfere with the right of free assembly. It substitutes suppression of the right of peaceable assembly for the duty to preserve order, and places the burden on citizens to avoid disorder, or to avoid meetings at which disorder by others may occur. Our forefathers, it has been said, did not exalt order at the cost of liberty.

Buckle, in describing this vice in the English statute condemned by the court, says:

It was also enacted that, even after these precautions had been taken, any single justice might compel the meeting to disperse, if, in his opinion, the language

¹¹ See Appendix III.

held by the speakers was calculated to bring the sovereign or the government into contempt; while, at the same time, he was authorized to arrest those whom he considered to be the offenders. The power of dissolving a public meeting, and of seizing its leaders, was thus conferred upon a common magistrate, and conferred too without the slightest provision against its abuse.

The 1947 indictment of Kaholokula and 74 others in the Paia incident, carefully drawn to the Territorial Supreme Court's specifications, after the elephantine words of the statute, charges that the 75 prevented five named persons from crossing the street and proceeding to the place of their employment, thereby endangering their life and liberty and impoverishing them. This appellants deemed a violation within the scope of the statute and sufficient to justify completely the making of a charge under the statute.

Such a statute surely must stand condemned under the doctrine of *Thornhill v. Alabama*, 310 U.S. 88, 96:

The charges were framed in the words of the statute and so must be given a like construction. The courts below expressed no intention of narrowing the construction put upon the statute by prior state decisions. In these circumstances, there is no occasion to go behind the face of the statute or of the complaint. Conviction upon a charge not made would be a sheer denial of due process. . . .

Proof of an abuse of power in the particular case has never been deemed a requisite for attack on the constitutionality of a statute purporting to license the dissemination of ideas. A like threat is inherent in a penal statute . . . which does not aim specifically at evils within the allowable area of State control, but, on the contrary, sweeps within its ambit other activities that in ordinary circumstances constitute an exercise of freedom of speech or of the press. *The existence of such a statute, which readily lends itself to harsh and discriminatory enforcement by local prosecuting officials against particular groups deemed to merit their dis-*

pleasure, results in a continuous and pervasive restraint on all freedom of discussion that might reasonably be regarded as within its purview. (Italics supplied.)

Appellants cite *Cole v. Arkansas*, 338 U.S. 345, as authority for upholding the statute. That the appellant Attorney General does not believe the scope of the two acts is the same is apparent from the fact that he sponsored and secured the passage not only of a new riot statute, but also of a statute almost identical with the Arkansas statute upheld by the court as applied in the particular facts before the court.

Professor Chaffee in his excellent, thought-provoking book *Free Speech in the United States* condemns as intrusions on free speech the use of unlawful assembly and riot statutes and conspiracy statutes, and shows that the ordinary criminal laws have proved adequate to cope with abuses of freedom of speech and assembly.

In Appendix III he lists state and territorial statutes affecting freedom of speech. An examination of that appendix shows that the territorial statute carried the most severe penalty existing in any state, bar none. For those states which have unlawful assembly and riot statutes, the average penalty appears to be not over three to six months.

Appellees believe it is clear from the foregoing discussion that the statute provides no ascertainable standard of conduct and therefore is void under the due process clauses of the Fifth and Fourteenth Amendments. As the Court said in *Lanzetta v. New Jersey*, 306 U.S. 451:

If on its face the challenged regulation is repugnant to due process clause, specification of the details of the offense intended to be charged would not serve to validate it. It is the statute and not the accusation under it, that prescribes the rules to govern conduct and warns against transgression. No one may be required at peril of life, liberty or property to speculate as to the meaning of penal statutes.

Obviously, what the statute prescribes would have to be determined by a court after the offense was committed. About all the poor citizen can do is to determine whether he is brave enough to sally forth to any meeting since without any overt act—albeit some violent thoughts—he may be guilty of a felony.

Appellants themselves sum up well the only manner in which the hapless citizen can know whether he has violated the law if he believes the risk of attending an assembly of sufficient importance:

1. if he is charged after the assembly;
2. what the charge says;
3. the testimony;
4. what instructions are given to the jury;
5. what the Supreme Court says on review;
6. what federal courts say after that. (B., p. 69)

The statute is so definite

1. that appellants Crockett and Bevins were unable to draw a sufficient charge under it;
2. Judge Wirtz thought they had;
3. three Supreme Court justices thought they had not, but thought the statute was constitutional;
4. three federal judges disagreed with the Territorial Supreme Court;
5. twenty members of the House of Representatives and fifteen members of the Senate thought it was good enough to prosecute the appellees under, constitutional or not;
6. ten members of the House disagreed.

B. The Statute is Void on Its Face and as Enlarged by the Interpretation Placed on It by the Territorial Supreme Court.

Appellants seem to believe that the scope of the statute was narrowed by the Supreme Court and its vagueness cured. The contrary is true. The scope of the statute was broadened. The statute, as authoritatively construed by the Supreme Court, was

- a. either repealed and the common law misdemeanor of riot substituted except for the 20-year felony provisions, or
- b. was broadened so that it could become a positive booby-trap for the citizen since attendance at an assembly at which violence occurred might subject him to the penalty, if any act of his or facial expression could be construed as "countenancing" or "concurring in the intent" of those who committed the violence.

If under the statute as construed, the common law misdemeanor of riot was made a 20-year felony, then it imposed a cruel and unusual punishment, being in excess of the penalty at common law. *Weems v. United States*, 217 U.S. 349. The amended penalty would be bad by the same tests.

Local police, as in the Paia incident, may take their cameras and their paper and pencils, and stand by as observers, or read some other statute for the edification of the assembly—such as loitering, or perhaps trespass.

Or the police may, if they desire, order the assembly to disperse, and if the citizen does not agree with him, he can always test the matter by becoming a defendant in a criminal trial.

If it be construed that the statute has been limited, by construction, it must surely fall within the doctrine of *United States v. Reese*, 92 U. S. 214, 222, where it is said:

We are, therefore, directly called upon to decide whether a penal statute, enacted by Congress, with its limited powers, which is in general language broad enough to cover wrongful acts without as well as within the constitutional jurisdiction, can be limited by judicial construction so as to make it operate only on that which Congress may rightfully prohibit and punish. For this purpose, we must take these sections of the statute as they are. We are not able to reject a part which is unconstitutional and retain the remainder, because it is not possible to separate that which is uncon-

stitutional, if there be any such, from that which is not. The proposed effect is not to be attained by striking out or disregarding words that are in the section, but by inserting those that are not now there. Each of the sections must stand as a whole or fall altogether. The language is plain. There is no room for construction, unless it be as to the effect of the Constitution. The question, then, to be determined is, whether we can introduce words of limitation into a penal statute so as to make it specific, when, as expressed, it is general only.

It would certainly be dangerous if the Legislature could set a net large enough to catch all possible offenders and leave it to the courts to step inside and say who could be rightfully detained and who should be set at large. This would, to some extent, substitute the Judicial for the Legislative Department of the Government. The courts enforce the legislative will when ascertained, if within the constitutional grant of power. Within its legitimate sphere, Congress is supreme and beyond the control of the courts; but if it steps outside of its constitutional limitation and attempts that which is beyond its reach, the courts are authorized to, and when called upon in due course of legal proceedings must, annul its encroachments upon the reserved power of the States and the people.

To limit this statute in the manner now asked for would be to make a new law, not to enforce an old one. This is no part of our duty.

C. The District Court Was Not Bound by the Construction Placed on the Act by the Supreme Court of the Territory.

The rule of deference has no application here because the United States Supreme Court has specifically condemned a statute of the exact type of this statute. This is not a question of local law, but a question involving protection of a right guaranteed by the federal constitution.

Federal courts are not bound by the construction placed on a statute where the question is a question of conflict with the federal Constitution. *Yick Wo v. Hopkins*, 118 U.S.

356. See also *Home Telephone Co. v. Los Angeles*, 227 U.S. 278.

In *United States v. Fullard-Leo*, 331 U.S. 256, the Supreme Court, after discussing the "doctrine of deference" pointed out that where the court is "dealing . . . with a problem of federal law . . . the federal courts construe the law for themselves." 331 U.S. 256, 269.

The rule of deference, if it be considered applicable here, is not controlling where the local decision is manifestly erroneous. *Treat v. Grand Canyon R. Co.*, 222 U.S. 448.

The rule of deference, as stated in *Waialua Agricultural Company v. Christian*, 305 U.S. 91, is that in so far as decisions of the Supreme Court of Hawaii are in conformity with the Constitution and applicable statutes of the United States and are not manifestly erroneous in their statements or application of governing principles, they are to be accepted as stating the law of the Territory.

The decision of the Supreme Court of Hawaii is both in conflict with the Constitution and manifestly erroneous.

The doctrine of *res adjudicata* has no application.

The case of *Territory v. Kaholokula* before the Supreme Court of the Territory of Hawaii was an interlocutory appeal on a question of law. As a result of the appeal, the criminal proceeding terminated in 12,301 in favor of the appellees because the decision required the discharge of appellees because of the defective indictment.

The suit in the federal court is not an attempt to set aside a judgment. There can be no final, appealable judgment in an interlocutory appeal.

Appellees sued to redress a deprivation of federal rights under a statute of Congress. The cases cited, being bills to set aside a judgment, are not apposite.

If appellants' theory were correct, an interlocutory appeal would deprive defendants in criminal cases from asserting the unconstitutionality of criminal statutes in all interlocutory appeals, if the ruling upheld the constitutionality of

the statute, and would deprive such defendants of due process of law.

III. THE CONSPIRACY STATUTE IS VOID ON ITS FACE.

The District Court held the conspiracy act void on its face (R. 461-467). This statute also is a product of the 1850 penal code. It has been consistently and persistently used against workers in every labor dispute since its adoption. Indeed, early strikes were referred to by the newspapers and the courts as "Higher Wage Conspiracies." See Memorandum on Labor and the Law, Appendix I, pp. 13, 15.

Appellants concede that the statute is void in part, but they contend that the court should not have stricken the statute down in toto, but should have separated the void from what they contend is the valid part.

They concede that the indictment against appellees at 12,301 is based on both the void and valid parts. The indictment charges that appellees conspired to beat and bruise the five named persons and to injure them by impoverishing them. According to appellants' witness, Mr. Freitas, no assault and batteries occurred. The 1946 indictment charged merely assaults and shoving and pushing, but not directed against the five named men. (R. 12,301, 32-34)

They have also sponsored and procured the passage of a new statute, reserving the right to proceed against appellees under the old.

The Supreme Court of the Territory, in *Territory v. Soga*, 20 Haw. 71, upheld a conviction of third degree conspiracy against four of the strike leaders. Each was sentenced to ten months imprisonment, \$300 fine, and one-fourth of the costs.

Soga was a newspaper editor, and so was Negoro. The means used in the conspiracy were newspaper articles agitating for higher wages.

The charge against the defendants was concerting together:

to do what plainly and directly tended to incite and occasion offense and to do what was obviously and directly injurious to another

by conspiring to prevent certain corporations owning sugar plantations in the County of Honolulu from carrying on their business and operating their plantations, and thereby impoverishing them by preventing them from carrying on their trade or business. The means charged were threats of violence directed against the corporations and all Japanese in the City and County who did not join with the Higher Wage Association.

The evidence in support of the threats of violence were articles appearing in a Japanese newspaper, the *Nippu Jiji*, in support of the Association which urged "sticking together" to secure higher wages, "whatever the consequences", and other implied threats, which the conspirators did not denounce; letters received by leaders from members of the Association counseling force, which letters were procured from a safe stolen from one of the conspirators with the assistance of the police; a draft of a play attacking an opponent of the strike—likewise found in the stolen safe; and speeches made by the conspirators "intended to stir up the laborers."

The Supreme Court's opinion is quite remarkable.

Defendants insisted that they were not responsible for the articles; that they constantly protested against any unlawful acts. In masterly prose, the court denied the contention:

This contention, however, cannot be sustained. Under all the circumstances which could have been found by the jury it was the duty of the defendants who deprecated the *Jiji* articles or did not wish to identify themselves with their publication to say so, and the inference could properly be made that although all of them may not be criminally liable for the writing and publishing of the articles they adopted and used them as part of

their "campaign;" and that they did this by mutual agreement, whether expressed or implied, is immaterial. Their urging that there be no violence or breach of the peace or anything unlawful done to incur the penalty of the law may or may not have been sincere. When Mark Anthony said to his audience, "Let me not stir you up to mutiny and rage," that was precisely what he meant to do and did do. The fact is that those who "sow the wind must reap the whirlwind," no matter how fervently they may have tried to avoid it. Urging or doing unlawful things is not condoned by urging that they be done lawfully.

It is of interest to note that the Territorial Supreme Court apparently did not consider the Fourth Amendment applicable in the Territory.

It is obvious that the conspiracy statute of the Territory is capable of being interpreted and is being interpreted by the appellants in exactly the same way in which the unlawful assembly and riot statute is being construed—to convert any picket line or concerted activity in a labor dispute into criminal activity for all so engaged if any single act of any individual or individuals makes it possible to do so. The common intent to picket is construed as being sufficient to give a common intent, a concurrence in intent or a combining together, sufficient to make all present, if any infraction of any law occurs, guilty of unlawful assembly and riot and conspiracy.

A mere reading of the conspiracy statute of the Territory shows that it is unconstitutional on its face because it provides no standard of conduct. As here applied, and as applied in *Territory v. Soga*, it is clear that it is also a threat to freedom of assembly and speech.

Section 1 of the statute (11120) defines a conspiracy as a malicious or fraudulent combination or mutual undertaking, or concerting together of two or more . . . to do what plainly and directly tends to excite or occasion offense, or what is obviously and *directly* wrongfully injurious to an-

other. The second paragraph of this section clarifies this by explaining that it is a conspiracy "to prevent another, by *indirect and sinister* means, from exercising his trade, and to impoverish him." The only standard laid down by the statute is a gastronomic test of the prosecuting officers in the first instance and the jurors thereafter.

The statute clearly purports to embrace more than criminal acts; it attempts to embrace moral judgments as well. It does not require a wilful doing of the acts charged as a conspiracy or that they be legally wrong.

In *Screws v. United States*, 325 U.S. 91, the Supreme Court rejected a contention that the section of the criminal code making it a federal crime to deprive another of rights under color of law was unconstitutional only because it required a wilful doing of the acts. But here there is a complete lack of any requirement of such criminal purpose or intent, and the conspiracy statute is clearly void within the exact holding of the *Screws* case.

In *United States v. L. Cohen Grocery Co.*, 255 U.S. 81, an act of Congress was struck down because its enforcement would have been "the exact equivalent of an effort to carry out a statute which in terms merely penalized and punished all acts detrimental to the public interest when unjust and unreasonable in the estimation of the court and jury." The act declared criminal the making of "any unjust or unreasonable rate or charge in handling or dealing in or with any necessities."

The conspiracy statute contains no definition or standard for determining what is meant by "or to do what plainly tends to excite or occasion offense, or what is obviously and directly wrongfully injurious to another." It does not refer to any source where these questions can be determined. The legislature did not define what it desired to punish, but referred the citizen to his own conscience and to a law library in order to ascertain what acts were prohibited. To enforce such a statute would be like sanctioning the practice

of Caligula who “published the law, but it was written in a very small hand, and posted up in a corner, so that no one could make a copy of it.”

Ernest Freund, in his criticism of the Debs case, wrote:

So long as we apply the notoriously loose common law doctrines of conspiracy and incitement to offenses of a political character, we are adrift on a sea of doubt and conjecture. To know what you may do and what you may not do, and how far you may go in criticism, is the first condition of political liberty; to be permitted to agitate at your own peril, subject to a jury's guessing at motive, tendency and possible effect, makes the right of free speech a precarious gift.

There can be no doubt that the Territorial conspiracy statute readily lends itself to harsh and discriminatory treatment by local prosecuting officers, including appellants, against particular groups deemed to warrant their displeasure, and that labor in the Territory and the appellees have been the victims of this harsh and discriminatory treatment.

The District Court was correct in refusing to attempt to rewrite the law.

The statute contains no severability clause, and had to be stricken down as a whole. See *United States v. Reese*, 92 U.S. 214, *supra*, p. 66.

On its face and as construed by the Supreme Court of Hawaii, it becomes infirm in all its parts.

Winters v. New York, 333 U.S. 507.

Terminiello v. Chicago, 337 U.S. 1.

Strangely, appellants did not see fit to cite the leading Hawaiian case on the subject, although they insist in respect to the unlawful assembly act that the Court is bound by the Supreme Court decision. It should be noted that the private law firm of Kinney, Ballou, Prosser & Anderson “assisted” the prosecution in that case.

IV. THE DISTRICT COURT HAD JURISDICTION OF THE GRAND JURY ISSUE, AND ITS FINDING THAT THE GRAND JURY WAS ILLEGALLY CONSTITUTED IS SUPPORTED BY THE EVIDENCE.

The District Court held that it had the power to hear and determine appellees' claim that they had been denied a fair and representative grand jury composed in accordance with constitutional standards and territorial law, and that the 1947 Maui County Grand Jury was selected in a manner which deprived plaintiff of federal and constitutional rights. (R. 486-512)

It is appellees' contention that the method of selection and composition of the grand jury pursued by the appellants, in the language of the *Screws* case, "flies in the teeth of the decision of the Supreme Court" relating to the proper selection and composition of juries, and that the judge who heard the challenge was so biased and prejudiced, as is manifested by the transcript of the hearing filed in these cases, that the appellees were denied due process of law.

In *Lane v. Wilson*, 307 U.S. 268, the right to sue of a person claiming deprivation of federal rights was upheld under Section 43 of Title 8 without resort to state courts. Justice Frankfurter upheld the right to sue under Section 43 for deprivation or inequality of treatment under color of law.

The appellees seek declaratory relief as redress for their deprivation of federal rights to a constitutionally selected grand jury.

The appellees here ask the Court to do no more than was done by the court in *Lane v. Wilson*.

Appellees' Bill of Particulars (R. 327) enumerates some of the specifications of the lack of due process in the hearing before Judge Cristy and of their deprivation of constitutional rights in respect to the grand jury by appellants under color of law.

The heart and substance of the appellees' claim for relief in respect to the grand jury is that by uncontradicted evi-

dence, they brought themselves directly within well established and well defined rules laid down by the Supreme Court of the United States for the selection of grand juries, and, despite this uncontradicted testimony, that Judge Cristy, in defiance of, and in the teeth of, Supreme Court decisions, upheld the method of selection and composition of the grand jury.

It appeared before Judge Cristy, and the appellants here concede, that no person of Philippine nationality has ever been selected on the grand jury list or summoned as a grand juror in Maui County up to and including 1947. It is conceded that there are qualified Filipinos.

Appellees showed before the circuit court that Patrick Ortello, who stated that he was of Filipino parentage, who went through the 8th grade in Hana School, who was employed by the Kahului Railroad Company, was marked "disqualified" by the Jury Commissioners. None of them was able to state any reason for disqualifying him.

Appellees showed, and the jury commissioners testified, that returned questionnaires of haoles and persons of other races unknown to the jury commissioners, showing less education, etc., were marked qualified and such persons were actually selected for jury service.

Appellees showed that at least seven or eight other questionnaires of Filipino citizens were marked questionable, although according to the returned questionnaires, these individuals had qualifications equal to or greater than persons actually selected for jury service.

Judge Cristy advised counsel for appellees that "questionable" meant "subject to further investigation." None of the jury commissioners up to that point had so testified. As a matter of fact, the jury commissioners testified that they had no funds for summoning prospective jurors, and that the only way a person could be further investigated was by one of the jury commissioners making private inquiries.

The only explanation offered about the absence of Fili-

pinos, although all jury commissioners admitted there were qualified Filipinos—was by Commissioner Pombo who testified that “they had people who were better.”

The showing of the complete exclusion of Filipinos from grand jury service in Maui County—although Filipinos constitute the second largest racial group in the county—for a period of at least 30 years, coupled with the unexplained marking of “questionable” and “not qualified” on returned questionnaires by Filipinos not personally known to any of the jury commissioners, certainly meets the tests of the *prima facie* case of ingenious or ingenuous exclusion on account of race laid down by the Supreme Court in a long line of decisions from *Strauder v. West Virginia*, 100 U.S. 303, to the recent *Patton* case.

As a matter of fact, the *Patton* case is on all fours with this case. There the judge refused to consider, as did Judge Cristy, that not only were Negroes excluded from the particular venire, but that no Negro had been selected for jury lists for a period of 30 years. Representatives of the State of Alabama made the same arguments that appellants make about the low percentage of qualified Negroes, compared with white persons, but the court brushed such reasoning aside, saying:

But whatever the precise number of qualified colored electors in the country, there were some; and if it can possibly be conceived that all of them were disqualified for jury service by reason of the commission of crime, habitual drunkenness, gambling, inability to read or write, or to meet any other or all of the statutory tests, we do not doubt that the state could have proved it. We hold that the State wholly failed to meet the very strong evidence of purposeful racial discrimination made out by petitioner upon the uncontradicted showing that for thirty years or more no negro had served as a juror in the criminal courts of Lauderdale County. When a jury selection plan, whatever it is, operates in such a way as always to result in the complete and long-continued exclusion of any representative at all from a

large group of Negroes, or any other racial group, indictments and verdicts returned against them by juries thus selected cannot stand.

The proof adduced by appellees that from the standpoint of race, the 1947 grand jury is not a cross-section of the population of Maui County, and therefore violates clearly enunciated principles laid down by the United States Supreme Court, is summarized in tabular form in a chart submitted to the court during oral argument. This summary is based upon the United States census classification of race. It shows:

Percentage Comparison, Race of Population
of Maui County¹² and of Grand Jury List, 1947,
Maui County

NATIONALITY		Percentage of Population of Maui County	Percentage of 1947 Grand Jury Panel
Japanese	24,183	43.2%	14%
Filipino	10,509	18.8%	0%
Part Hawaiian	7,915	14.1%	24%
Caucasian	6,989	12.5%	54%
Hawaiian	2,946	5.3%	0%
Chinese	1,513	2.7%	8%
Other Races	1,925	3.4%	0%
(Korean, Puerto Rican)			

The record shows that the appellees offered to prove before Judge Cristy, but were not permitted to prove, that if selected at random from qualified persons in order to secure a cross-section, a grand jury of this racial composition would not occur in Maui County more than once in ten million times.

Appellees adduced proof showing that in the Territory of Hawaii, different mores and attitudes exist than in a typical

¹² Census classification of Race of Population of Maui County. 1940 Population—55,980. Dept. of Health, Bureau of Health (Vital) Statistics, T. H., show little change in racial characteristics, 1940 to 1946. Population, estimated as of July 1, 1946—55,904.

mainland community, and that an analysis of the racial composition of the 1947 grand jury according to census classifications does not reflect the full extent to which the method of selection and composition employed by the jury commissioners fails to result in the selection of a cross-section of the community, or of those qualified for jury service. Thus, in island mores, it was shown that persons of Portuguese national background are not considered Caucasians. It was shown that there is a general division of the population into two classes: haole (white) and non-haole, which includes all other races. Portuguese are classified either as non-haole or in a separate class by themselves. It was further shown that the term "haole" has a generally accepted economic as well as racial connotation and means "a white man with a good job."

One of the jury commissioners of Portuguese extraction very clearly establishes this. After testifying that he considered himself white, but that the "haoles" did not so consider him (Transcript before Judge Cristy, p. 267), he finally testified on cross-examination:

No, I don't consider a Portuguese a white man. They consider us as niggers here. We are not classed as white men. They don't even class us as Caucasians themselves and I told you that yesterday, and I would like to have that included—that Portuguese are not called Caucasian. (R. 875)

When asked why he picked haoles, Commissioner Pombo testified as follows:

Witness: No, I pick them because I want to give them something to do—if they want a chance to run the country—

The Court: Did you pick them because of their fairness?

Witness: Because they are fair. They are in court—they have to be fair. There is another jury—in case it don't go right on the Grand Jury, the trial jury is waiting for them.

Mr. Resner: What did you mean a moment ago—you said they wanted a chance to run the country?

A. Well, they do run the country.

Q. How do you mean that?

A. The majority—lots of these—the Baldwins—they own the place. (R. 830-831)

An analysis of the composition of the 1947 grand jury based on accepted Island classifications shows:

Percentage Comparison of "Nationality" of Population of Maui County, 1940, and of Persons on the 1947 Grand Jury Panel, Maui County¹³ "Nationalities" Roughly Ranked as to Socio-Economic Status

NATIONALITY	Percentage of Population	Percentage on Grand Jury
Haole	3.6%	42.0%
Portuguese	8.8%	12.0%
Caucasian-Hawaiian	7.4%	20.0%
Other Part-Hawaiian	6.8%	4.0%
Chinese	2.7%	8.0%
Japanese	43.2%	14.0%
Korean	1.4%	0
Hawaiian	5.3%	0
Puerto Rican	1.9%	0
Filipino	18.8%	0

Clearly, the 1947 grand jury does not represent a cross-section of the community of Maui County. Appellees also showed that the same high percentage of haoles in the Maui County Grand Jury existed for the preceding five years. (Plaintiffs' Exhibit No. 26)

Appellees contended and proved before Judge Cristy that the 1947 grand jury was not an accident, but a fixed pattern of jury selection in Maui County. No evidence was offered to rebut appellees' proof.

¹³ Number of Haoles ("Other Caucasians"), Portuguese (including Spaniards), Caucasian-Hawaiians and other Part-Hawaiians, Koreans and Puerto Ricans obtained by carrying forward the 1930 proportions of these categories.

Not only did appellees prove that the grand juries for 1947 and the preceding five years are not a cross-section of Maui County racially, but that they are even less representative economically.

Judge Cristy accused the appellees of making up, out of whole cloth, class antagonisms and prejudices. That class prejudices do exist has been recognized in jury selection since the time of Blackstone, and the Supreme Court takes judicial notice of it.

Apparently, Judge Cristy and the jury commissioners, based upon their actual selection and their testimony about the qualifications necessary for a "good" juror, agree with Sir James Stephens who, in his *History of Criminal Law*, which appeared in 1882, said:

I cannot say much for the intelligence of small shopkeepers and petty farmers, and whatever the fashions of the times may say to the contrary, I think that the great bulk of the working classes are altogether unfit to discharge judicial duties. . . I think that the habit of flattering and encouraging the poor, and asserting they are just as serviceable and capable of performing judicial and political functions as those who from their infancy have had the advantages of leisure, education, and wealth, has led to views as to the persons qualified to be jurors which may be very mischievous. . . In short, I think a good judge and a good special jury form as strong a tribunal as can be had, but I think a judge without a jury would be a stronger tribunal than an *average common jury*. (Lloyd Paul Stryker, *For the Defense*, p. 211)

Appellees' analysis of the 1947 grand jury based generally upon United States census classifications of occupation shows:

Percentage Comparison, Socio-Economic Classes, Gainfully
Employed Persons of Maui County, 1940, and Grand
Jury List, Maui County, 1947¹⁴

SOCIO-ECONOMIC CLASSES	Percentage of Population	Percentage of Panel
Proprietors and Managers (Im- portant firms and/or large branches)	0.6%	24.0%
Other Proprietors, Managers, officials and foremen.....	4.9%	40.0%
Professional and Semi-profes- sional	3.2%	8.0%
Farm Foremen	2.5%	0
Farmers	2.5%	4.0%
Clerical, sales, etc.....	6.4%	12.0%
Craftsmen and Operatives.....	18.1%	6.0%
Laborers, Non-Farm	9.9%	2.0%
Farm Laborers	47.1%	0
Service Workers	4.7%	0
Occupation Not Specified.....	0.3%	4.0%

That this economic composition was not accidental ap-
pears from Commissioner Pombo's testimony:

Q. ... What standard did you use?

A. Well, we picked men—majority of them with bet-
ter education. They are in business in the community.

Q. Yes. Was it your feeling that a man in business
would be better qualified than a man out of business?

A. He has got a better head on him.

Q. Is that the conclusion you arrived at?

A. If I can pick a business man, got a business of his
own, and good moral character, I would just as soon
pick him than pick some juror I don't know anything
about other than what you see on paper. (R. 855-856)

Fay v. New York, 332 U.S. 261, holds that a state may,
consistent with the due process of the Fourteenth Amend-
ment, try one charged with a crime by a so-called special or

¹⁴ Adapted from Table 3, with certain classes combined and/or
divided; Grand Jury data corrected.

blue-ribbon jury. The court, however, carefully distinguished between state and federal juries and the decisions touching each.

The Territory of Hawaii exercises only power delegated by Congress, and Congress cannot, without an amendment to the Constitution, deny the right of trial by jury or indictment by a grand jury.

That this constitutional guaranty means a grand jury is a cross-section of the community is not now open to question in the light of Supreme Court decisions on jury standards in federal courts.

It must be taken as settled then, that the territorial legislature could not adopt a blue-ribbon jury system. Yet, a comparison of the occupational classification of the blue-ribbon jury in the *Fay* case and the 1947 Grand Jury of Maui County shows that the *Fay* jury was less packed than the 1947 grand jury with the economically privileged, as is shown by the following table:

	Percentage of total experienced labor forces		Percentage of representation	
	Man- hattan	Maui County	"blue ribbon" panel	Maui County
Professional and semi- professional	12.1	3.2	18.8	8
Proprietors, managers and officials	9.3	5.6	43	64
Clerical, sales and kin- dred workers	21.3	6.4	38	12
Craftsmen, foremen and kindred workers	7.7	20.16	0.2	6
Operatives and kin- dred workers	17		0	
Service workers	27.6		0	
Laborers	4.9	57	0	2
Farmers	0.1	2.5	0	4
Not specified .....		.3		4

In the blue-ribbon jury, 99.8% were picked from groups representing 42.7% of Manhattan's population. In Maui County Grand Jury, 84% of the jury were picked from groups representing 15% of the population.

Even in the majority opinion in the *Fay* case, the court recognized that the exclusion of workers in a case growing out of a labor dispute might present a different problem. Here, unlike in the *Fay* case, the plaintiffs are farm laborers who are excluded totally from the jury.

The appellees' evidence also shows that an overwhelming number of the jurors on the 1947 panel were personally known to the jury commissioners. Thus, all but 9 of the 50 were known to the jury commissioner, Chatterton; all but 10 of the 50 were known to the jury commissioner Pombo; and 30 of the 50 were known to the jury commissioner, Wirtz.

The Supreme Court has condemned in *Smith v. Texas*, 311 U.S. 128, the selection of personal acquaintances by jury commissioners on the ground that it makes suspect the securing of a true cross-section of the community.

Appellees' evidence clearly and unequivocally falls within the scope of decisions of the United States Supreme Court condemning identical practices in the selection of juries as shown here, and holding evidence of the same character sufficient to show that the jury in question was not a cross section.

This evidence was before Judge Cristy and the decisions were called to his attention in the course of the hearing on the challenge. It is, therefore, submitted, that Judge Cristy's action in overruling the challenge "flies in the teeth" of express holdings of the Supreme Court, and that appellees' evidence supports the findings of the District Court.

In 12,301, where the 1947 grand jury has already indicted appellees, the question of the legality of the selection and composition of the grand jury is not moot. Nor is the contention valid that the appellees in the Kaholokula case vol-

untarily adopted the ruling of the challenge in the Barbosa case. They had no choice.

The order of the Supreme Court of the Territory designating Judge Cristy as substitute judge, ordered and authorized him to hear and determine the question of any challenges to the grand jury of 1947, whether in the Barbosa case or otherwise, and Judge Cristy, pursuant to this authority, specifically ruled that the method of selection and composition of the Maui grand jury was in accordance with law and that the Barbosa case *and all other cases* could be presented to said grand jury.

There is no remedy by appeal from Judge Cristy's ruling, and even if there were, it would subject appellees to a further deprivation of rights.

It is clearly the law that if the grand jury is, as alleged by appellees, unconstitutionally composed, all proceedings taken thereafter are annulled. Thus, in *Patton v. Mississippi*, decided December 8, 1947, the Supreme Court reversed a conviction and directed that the indictment be quashed because of the improper selection of the grand jury.

Under our Constitution, the jury is not to be made representative of the most intelligent, the most wealthy or the most successful, nor of the least intelligent, the least wealthy or the least successful. It is a democratic institution representative of all classes of people.

Thus, the Supreme Court in *Strauder v. West Virginia*, 100 U.S. 303, stated:

The very idea of a jury is a body of men composed of the peers or equals of the person whose rights it is selected or summoned to determine; that is, of his neighbors, fellows, associates, persons having the same legal status in society as that which he holds. Blackstone, in his Commentaries, says, 'the right of trial by jury or the country is a trial by the peers of every Englishman and is the grand bulwark of his liberties, and is secured to him by the Great Charter.' It is also guarded by statu-

tory enactments intended to make impossible what Mr. Bentham called 'packing juries.' It is well known that prejudices often exist against particularly classes in the community, which sway the judgment of jurors, and which therefore, operate in some cases to deny to persons of those classes the full enjoyment of that protection which others enjoy.

The evidence of weighting of the grand jury in favor of business clearly is in direct violation of this decision.

All of the appellees belong to the excluded class, and their alleged offense arose out of a labor dispute.

The decisions of the Supreme Court of the United States have made it clear that a jury which excludes in whole or in part representatives of the employee class is not a cross-section of the community. The court has specifically condemned any tendency which would cause a jury to become representative of the economically and socially privileged, and has struck down a practice of jury commissioners which causes this result even though the particular jury in question in fact had representatives of the working class.

Thus, in *Thiel v. Southern Pacific Company*, 328 U.S. 217, the court said:

Wage earners, including those who are paid by the day, constitute a very substantial portion of the community, a portion that cannot be intentionally and systematically excluded in whole or in part without doing violence to the democratic nature of the jury system. Were we to sanction an exclusion of this nature we would encourage whatever desires those responsible for the selection of jury panels may have to discriminate against persons of low economic and social status. We would breathe life into any latent tendencies to establish the jury as the instrument of the economically and socially privileged. That we refuse to do. . . .

To reassert those standards, to guard against the subtle undermining of the jury system, requires a new trial from a panel properly and fairly chosen.

Even the dissenting justice in the *Thiel* case recognized and stated specifically the method of selection must not be tainted by property prejudice:

The process of justice must of course not be tainted by property prejudice any more than by race or religious prejudice. . . .

If workmen were systematically not drawn for the jury, the practice would be indefensible. . . .

In *Fay v. New York*, 332 U.S. 261, the Supreme Court said that even though states could abolish the traditional system, they could not exclude in whole or in part representatives of certain classes in certain kinds of cases.

The court said:

There may be special cases where exclusion of laborers would indicate that those sitting were prejudiced against labor defendants as where a labor leader is on trial on charges growing out of a labor dispute. The situation would be similar to that of a Negro who confronts a jury on which no Negro is allowed to sit. He might very well say that a community which discriminates against all Negroes discriminates against him.

If Benjamin Fairless and the directors and managers of all large business concerns in a steel town were assembled as a grand jury, during the course of a strike in the steel industry, to consider alleged charges of violence by striking steel workers, it may be assumed that such a case would fall within the category of special cases to which the court referred.

The United States Steel Corporation, giant as it is in the economic structure of the United States, is small in comparison with the Baldwin interests in the community of Maui County, which includes the Islands of Maui, Lanai and Molokai.

Alexander & Baldwin, Ltd., one of the Five Factors of Hawaii, and the Baldwin Family had, at the time of the grand jury challenge, controlling interest in two of the four

sugar companies in the county—Hawaiian Commercial & Sugar Company and Maui Agricultural Company, now combined, which in turn owned the East Maui Irrigation Co., two of the four pineapple companies, Baldwin Packers and Maui Pineapple Co., two of the largest ranches, Haleakala Ranch and Ulupalakua Ranch, the Maui Electric Company and the Kahului Railroad. (R. 578-583)

At the last time any ascertainable estimate was available, in approximately 1933, \$15,000,000 out of \$24,000,000 of the sugar assets of Maui County, as evaluated at that time, were in the control of the Baldwin Family.

The industries of Maui County are sugar, pineapple, with ranching a poor third. In each field, Alexander & Baldwin or the Baldwin family had the dominating interest in the county.

Both the sugar and pineapple strikes were industry-wide and therefore affected the Baldwin interests directly.

To paint the picture concretely, and not abstractly by percentages, the 127 sugar and pineapple workers involved in this case faced a grand jury composed of 17 men—8 of whom were management representatives of the Baldwin interests.

They are: Edwin H. Baldwin, Manager, Ulupalakua Ranch; Richard H. Baldwin, Manager, Haleakala Ranch; Robert P. Bruce, Manager, East Maui Irrigation Company; John Plunkett, Supervisor, East Maui Irrigation Co.; E. Stanley Elmore, Board of Directors, Maui Electric Company, and President and Manager of Valley Island Motors; Herbert Petersen, Manager, Plantation Store, Hawaiian Commercial & Sugar Company; Jack Costa, Chief Electrician, Hawaiian Commercial & Sugar Company; Edward S. Bowmer, Cashier and Assistant Bookkeeper, Baldwin Packers.

Jury Commissioner Pombo's statement that the Baldwins were put on the jury because they owned the country and wanted to run the country, seems substantiated, to the extent at least that they were put on the jury.

The remaining 9 jurors were: Kenneth Auld, Section Superintendent of California Packing Co., Molokai; Paul R. Reinhart, Assistant Plantation Manager, Libby, McNeill & Libby, both pineapple companies involved in the strike; Joseph H. Frank, Manager, Bank of Hawaii; Allen Ezell, Branch Manager, Hawaiian Airlines; Henry S. Fong, contractor and manager; Anthony Tam, farmer; Wai Ken Tom, Office Manager, Mutual Telephone Company; and Walter Holt, Forester, of the Board of Forestry.

Racially, the composition of the grand jury was as follows:

	Percentage of Population	No.	Percentage of Panel
Haole	3.6	11	64.7
Caucasian-Hawaiian	7.4	3	17.65
Chinese	2.7	3	17.65
Total	13.7		100.

In other words, racially, groups representing 13.7% of the population had 100% representation of the jury, leaving unrepresented 86.3% of the population to which racial groups appellees belonged.

Economically, the composition of the grand jury was as follows:

	Percentage of Population	Percentage of Grand Jury
Proprietors and managers of important firms or large branches.....	.6	41
Other proprietors, managers, officials and foremen.....	4.9	30
Professional and semi-professional....	3.2	11
Farmers	2.5	5.9
Craftsmen and operatives.....	18.1	5.9
Not specified .....	.3	5.9

There is only one juror who even approaches what might be considered a laborer, and he is the **Chief Electrician at Hawaiian Commercial & Sugar Company**. Classing him as a representative of the laboring class, economic groups rep-

representing 11.5% of the community had 94% representation on the jury.

Jury Commissioner Pombo's statement that the jury commissioners thought business men were better jurors seems to have been applied by all the commissioners as a criterion.

It is to be remembered that in the special blue-ribbon jury in the *Fay* case, which cannot constitutionally exist in Hawaii, groups representing 42.7% of the population had 99% representation on the jury.

When it is considered that all these facts were presented to the territorial court and overruled; when it is considered that of the 17 grand jurors, 10 were important officials of companies seriously affected by both the sugar and pineapple strike, it seems that appellees have made out a case of a denial of a fair and impartial grand jury—well within the exact quantum of proof the United States Supreme Court has said shows discrimination based on race and economic classes.

The Bar Association of Hawaii and appellants urge on this Court that evidence in the record does not support the findings of the District Court.

If it is true that there is no place in our system of government for the exercise of purely arbitrary power, *Yick Wo v. Hopkins*, 118 U.S. 356, surely appellees are entitled to redress for the denial of a fair and impartial grand jury.

And since it is the established practice of the United States Supreme Court:

to sustain the jurisdiction of federal courts to issue injunctions to protect rights safeguarded by the Constitution and to restrain individual State officers from doing what the Fourteenth Amendment forbids the State to do. *Bell v. Hood*, 327 U. S. 678

the Federal District Court must have the power to redress appellees' denial of a fair and impartial grand jury by appellants acting under color of law.

CONCLUSION

The District Court for the District of Hawaii, sitting *en banc* had jurisdiction to hear and determine these two causes, and the exercise of its equitable discretion was proper.

The District Court's findings of facts are supported by the evidence. In all instances of disputed facts the District Court accepted the testimony of the witnesses for appellants. In short the District Court found that taking the facts in the light most favorable to appellants, appellees were entitled to relief from a continued denial of constitutional and federal rights.

The District Court found that since territorial courts have already passed on all questions of law adverse to appellees, there is no possibility of relief from the continued denial of rights short of appeal to this Court.

This indeed is a case which presents even stronger reasons for the refusal of this Court to interfere with the exercise of judicial discretion by the District Court than appeared in *Public Utilities Com. v. United Fuel Gas Co.*, 317 U.S. 456. There the Supreme Court, in refusing to interfere with a three-judge court's decision granting an injunction, said at page 469:

It is perhaps unnecessary at this late date to repeat the admonition that the federal courts should be wary of interrupting the proceedings of state administrative tribunals by use of the extraordinary writ of injunction. But this, too, is a rule of equity and not to be applied in blind disregard of fact. And what are the commanding circumstances of the present case? First, and most important, the orders of the state Commission are on their face plainly invalid. No inquiry beyond the orders themselves and the undisputed facts which underlie them is necessary in order to discover that they are in conflict with the federal Act. . . . In these circumstances, we cannot set aside the decree of the

District Court as an improper exercise of its equitable jurisdiction.

The two statutes declared invalid are clearly as the District Court found, void on their face. The method pursued in the selection of the grand jury meets the standard of proof well defined by decisions of the United States Supreme Court.

Past deprivation of rights, and threatened continued deprivation of rights has been clearly shown. The grave irreparable injury to appellees has been established by the evidence and found by the District Court.

This case is many-faceted, legally and factually. Had appellants been able to show that one or more of the facts found by the District Court were erroneous, even that would not be sufficient to entitle appellants to a reversal in this case. The question before this Court is whether under all the facts and circumstances and under the law substantial justice has been done.

Three federal judges who heard the facts unanimously concluded that appellees were entitled to relief if justice were to be done in accordance with the requirements of the Constitution and laws of the United States.

The decree and judgments in both cases should be affirmed.

Dated at Honolulu, T. H., this 25th day of May, 1950.

Respectfully submitted,

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HARRIET BOUSLOG

By HARRIET BOUSLOG

Attorneys for Appellees.

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APPENDIX I

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF HAWAII

INTERNATIONAL LONGSHOREMEN'S & WAREHOUSE-
MEN'S UNION, a Voluntary, Unincorporated Asso-
ciation and Labor Union, et al.,

Plaintiffs,

vs.

WALTER D. ACKERMAN, JR., Individually and as
Attorney General of the Territory of Hawaii,
et al.,

Defendants.

Civil
No. 828

INTERNATIONAL LONGSHOREMEN'S & WAREHOUSE-
MEN'S UNION, a Voluntary, Unincorporated Asso-
ciation and Labor Union, et al.,

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WALTER D. ACKERMAN, JR., Individually and as
Attorney General of the Territory of Hawaii,
et al.,

Defendants.

Civil
No. 836

MEMORANDUM ON HISTORY OF LABOR AND
THE LAW IN THE TERRITORY OF HAWAII

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During the course of the hearings on these cases, the parties were asked to supply the court with a history of labor cases before territorial courts. Investigation unfortunately disclosed that no such study had ever been undertaken before and that the background and history of labor cases in the criminal courts of the Territory were buried and unreported before District or Police and Circuit Courts. It also appears that in few cases growing out of labor disputes were the accused represented by counsel and hence few ever reached the Supreme Court of the Territory and only one, so far as counsel has

been able to find, ever reached the federal courts on appeal from territorial courts.¹

It will be recalled that the same obstacle was encountered by Justice Frankfurter² in attempting to record the history of the labor injunction and contempt proceedings in both state and federal courts.

The historical background is important in order to place the instant cases in proper setting and in order to understand the suppression of labor rights in the Territory and the role of the courts in the area of economic conflict. Therefore, counsel for plaintiffs have endeavored to piece together from official reports and from contemporary reports in the daily press and from such court decisions as exist a record which will speak for itself, so that the court may draw its own conclusions.

Labor organizations in the Territory of Hawaii made little progress until 1945. That this was due in no small part to a suppression of labor's rights is indicated by government reports. A report of the United States Department of Labor on Hawaii in 1929-1930³ states:

Labor organizations in the Hawaiian Islands are few in number, small in membership, and with the exception of the barbers' union, have no agreements with the employers. (Page 117)

A succeeding Labor Department Report in 1939^{3a} states:

The high degree of intercorporate control makes it impossible to mobilize the resources of all large enterprises to restrict the growth of labor unions and to combat strikes in whatever fields

¹ *Goto v. Lane*, 265 U.S. 393. This was an appeal from a denial of a writ of habeas corpus by the federal district court for Hawaii after the conviction of fifteen leaders of the Hawaiian Higher Wage Consummation Association for conspiracy after the 1920 strike. The Supreme Court did not consider the case on its merits, but held that counsel for workers had waived defects in the indictment, and that since counsel for defense had permitted their time to appeal for writ of error to elapse, so as to lose their opportunity for review, they were not entitled to habeas corpus as a substitute, and the issuance of a writ became discretionary under these circumstances.

² See Frankfurter and Greene, "The Labor Injunction." (1930)

³ Labor Conditions in the Territory of Hawaii, 1929-1930, United States Department of Labor, Bulletin No. 534 of the Bureau of Labor Statistics.

^{3a} Labor in the Territory of Hawaii, 1939, 76th Congress 3d Session, House Document No. 848, Bulletin No. 687, United States Department of Labor, Bureau of Labor Statistics.

of industry they may occur. There is a tendency on the part of management to assume that unionism is synonymous with dangerous radicalism, possibly because the labor movement in Hawaii has not always been wisely led. The result of this attitude is the feeling that labor unionism is a common menace to all Hawaiian enterprise, and that the duty of combating its development is a common problem of the management of all industries whenever labor trouble occurs. Thus, although management has done much for labor in Hawaii, it has used every influence at its command to restrict labor organization.

* * * * *

The position of the individual plantation worker is especially vulnerable. The house in which he lives, the store from which he buys, the fields in which he finds his recreation, the hospital in which he is treated, are all owned by plantation management which in turn has its policies controlled from the offices of the factors in Honolulu.

Whether it is justified or not, there is a prevalent feeling among the majority of Hawaiian workers that a bad record with any important concern in the Territory makes it difficult to obtain employment in any other concern, and that to be associated with labor union activities is certain to weaken their employment opportunities, if not destroy their economic future (Page 198).

* * * * *

In comparison with the highly integrated character of industrial management, the organization of labor in the Territory is meager.

To understand the development of labor organization in Hawaii, it is necessary to remember that in less than 70 years the population has increased from 56,000 (in 1872) to well over 400,000 * * * * (Page 199).

The total membership of all unions in the Territory has been increasing. Accurate figures are not available. Estimates of total membership by union officials vary from 3,500 to 6,000 members. Even if the larger figure is accepted as accurate, it would indicate that less than one twenty-fifth of the gainfully employed are unionized (Page 203).

I. CONDITIONS OF LABOR PRIOR TO 1900

A. Contract Labor

Indentured servitude existed in Hawaii for the fifty years preceding the annexation to the United States and the extension of the protection of the United States Constitution to the people of Hawaii. Although this slavery was prohibited by the Organic Act, so strong

were the habits and attitudes of mind characteristic of both servant and master under such a system that conditions for labor changed little until far into the twentieth century.

The Commissioner of Labor on Hawaii in his 1902 Report⁴ summarizes the history of the penal labor contract law in the years preceding annexation. (The original act was passed in 1850. Contract labor was abolished June 14, 1900.)

The seamen's or penal contract act appears with unimportant changes as the master and servant law of the Hawaiian civil code or compilation published in 1859. The essential features were:

(1) Any person not a minor might bind himself or herself out by written contract to serve another in any art, trade, or occupation for a period not to exceed five years.

(2) Any similar contract made in a foreign country, in accordance with the laws of that country, would be held binding in Hawaii, but its term must not exceed ten years.

(3) For willful absence or refusal to work, a contract servant might be apprehended and sentenced by any district or police magistrate to serve his employer not to exceed double the time absent, after the date of the expiration of his contract, but such extra period should not exceed one year. For continued refusal to work, a contract servant might be committed to prison.

(4) A district or police magistrate might terminate a contract if a charge of cruelty or of violation of contract was sustained against an employer.

An amendment in 1860 authorized magistrates to impose not to exceed three months' imprisonment, besides the additional period of service already provided for, upon contract servants deserting a second time. . . (Page 13)

The amendments of 1872 greatly improved the legal status of contract men. Though the courts condemned the practice as illegal, the old ship custom of flogging laborers for disorder or disobedience still obtained on some plantations. It was impossible to secure the conviction of the guilty parties in such cases because the flogging was not done in the presence of witnesses. The first of the amendments mentioned made the complainant—i.e., the laborer—a competent witness in a suit of this character, and provided for his discharge from his contract and for fining or imprisoning the employer if he proved his case. A second amendment rendered a contract by a married woman invalid, and provided that any contract for service made by a woman should be voided by her subsequent marriage. The third amendment provided that when a servant was sentenced by a

⁴ Report of the Commission of Labor on Hawaii (1902).

court to make up time lost by desertion, he should be paid for such time at the rate stipulated in the contract. The fourth amendment, which was evidently intended to prevent peonage, prohibited masters from holding a servant to work beyond the expiration of his regular term of service for any debt or advance made during the period of the contract. The final amendment provided for special officers who should acknowledge all contracts for service. Advances were required to be paid the laborer in the presence of one of these officers. It was further required that all fees and commissions for securing and contracting labor should be paid by the employer, and should not be deducted in any way from the wages of the laborer as stipulated in the contract.

An amendment was passed in 1876 substituting fines and imprisonment for service beyond the term of the original contract in case of desertion. (Page 15)

An act was passed in 1882 limiting advances to servant entering upon contracts to \$15 if the period of the contract was for one year, and to \$25 if it were for a longer term. An exception was made of money advanced to pay the passage of immigrants. (Page 15)

The courts ruled that time lost to an employer through the illness of a servant need not be made up at the expiration of the contract. (Page 16)

The law did not require that the kind of service or the place where it was to be performed should be definitely specified in the contract. (Page 16)

From the Biennial Report of the Attorney General to the Legislative Assembly⁵ in 1882, we find how attempts to rebel against indentured servitude were suppressed by the government:

Among the number of arrests herewith furnished there have been no less than 3,454 for "desertion of service." Take this into comparison with the number ten years ago, when there were only 568 arrests for that offence, and you can see the amount of travel and work for this offence alone which is done by the police. This increase is caused solely by the increase in sugar plantations throughout the Islands, and these arrests have enormously increased the expenses of the prisons and lock-ups, as each person is fed from one to three days ere being sentenced or discharged. (Page 13)

By 1890, the number of arrests for attempt to evade plantation

⁵ Biennial Report of the Attorney General to the Legislative Assembly of 1882.

slavery had again jumped. The Attorney General in his Report to the Legislature⁶ for the biennial period ending March 31, 1890, reports:

It will be noted that the largest number of arrests made are for deserting contract service amounting as follows:

	Arrests	Convictions
Hawaii	2,473	2,372
Oahu	522	486
Maui	1,078	905
Molokai	12	12
Kauai	1,721	1,612
	<hr/> 5,706	<hr/> 5,387

or in other words to nearly one-third of the arrests and about three-eighths of the convictions over the whole group. (Page 37)

The Biennial Report of the President of the Board of Immigration⁷ in the same year, 1890, gives us a breakdown of Hawaii's plantation labor force in that year:

Total Unskilled Plantation Laborers, 17,895

	Males		Females	Minors
	Contract	Day	Day	
Hawaiians	900	954	19	
Portuguese	463	1867	271	416
Japanese	5694	952	914	
Chinese	303	4214		
South Seas Is.	252	123	58	
Americans		101		
British		80		
Other Natn's		314		
	<hr/> 7612	<hr/> 8605	<hr/> 1262	<hr/> 416

Thus, in the year 1890, when there were 7,612 contract laborers on sugar plantations, there were 5,706 arrests for deserting servitude and 5,387 convictions.

The Attorney General in his 1890 Report⁸ concludes that the cost to the government of police work in enforcing these contracts was great:

⁶ Report of the Attorney General to the Legislature for the Biennial Period Ending March 31, 1890.

⁷ Biennial Report of the President of the Board of Immigration to the Legislature of 1890 (Page 33).

⁸ Report of the Attorney-General to the Legislature for the Biennial Period Ending March 31, 1890, Page 43.

It will be seen that over one-third of the police work on the other islands is taken up with this matter. Here in Honolulu it is a considerable expense to us as we have to keep four or five men in full pay, as interpreters and policemen, to attend to nothing else who are thus not available for patrol or regular police duty. I am of the opinion that the Government is put to considerable expense for the benefit of the employers of labor; and, were no warrants of arrests allowed to be issued by law for contract laborers, the police force could be considerably reduced. . . .

The Attorney General's above comment was apparently budgetary. There were few protests, except from the indentured servants themselves, about the system. An occasional reference indicates that some churchmen disapproved of the flogging of workers which was a concomitant of the system.⁹

B. Use of Corporal Punishment by Planters' Agents

The record shows that the practice of using physical force against indentured servants persisted. In 1875, Charles T. Gulick, President of the Board of Immigration, upon the importation of a considerable number of Japanese indentured laborers, inserted the following warning in the *Planters' Monthly*:¹⁰

It has further been distinctly considered and determined by the Government, that no employer or overseer (*luna*) shall be permitted, under any circumstances (except in self-defense) to strike or lay hands upon any contract laborer who is recognized as a Government ward . . . It is rendered all the more important when considered in the light of the sensitive nature of the

⁹ In 1866, the Rev. Elias Bond, writing to the Honolulu agents of the Kahala Plantation concerning the manager stated: "If he returns to Kohala Sugar Company, it must on condition that the people shall be allowed to hold their regular weekly (prayer) meeting. They must be allowed a newspaper, if they wish. Above all, *flogging* is to be *abandoned*. We must try to train *men*, and not brutes. A man flogged for stealing, and rendered sulky by such treatment, undoubtedly set fire to the carpenter shop recently. This style of management *must* be abandoned." (Ethel M. Damon, "Father Bond of Kahala, A Chronicle of Pioneer Life in Hawaii," Page 189.)

¹⁰ "Planters' Monthly," 4:117, communication dated Aug. 10, 1885 by Chas. T. Gulick.

Japanese race, in particular, which renders any rough-handling of the laborer abortive, if intended to secure obedience.

And again, in 1886, in his Report to the Legislative Assembly, the President of the Bureau of Immigration stated:¹¹

In regard to arrests and seizures, planters had been informed that they had no right to act for themselves, and had been warned against allowing any employee to lay hands upon the Japanese, as a violation of the rule would be deemed by the Government sufficient cause for the removal of any such person.

C. Government Protection of Planters' Labor Contracts

Actually, the planters had little need to act for themselves. The Citizens Guard, predecessor of the National Guard, police officers, the courts in criminal prosecutions, and in orders of deportation rendered the planters able assistance.

The references to the Citizens Guard in the Attorney General's Biennial Reports to the Legislative Assembly in 1882, 1897 and 1899 indicate the useful purpose served by the guard.

Thus in 1882, the Attorney General reports:¹²

It is highly improbable that in a country where there are so many laborers employed, disturbance of a serious character should not take place, which could be suppressed only by a well drilled, and especially well officered body of men.

Again, in the 1897 Report:¹³

The Guard is a useful organization and should be encouraged. Riots among our Japanese and Chinese labor are not uncommon occurrences and it is the presence of the Guard that gives assurance of security that otherwise would not prevail.

And again, in 1899:¹⁴

The companies of Citizens' Guard in these outer Districts are

¹¹ Report of the President of the Bureau of Immigration to the Legislative Assembly of 1886, Pages 232, 234.

¹² Biennial Report of the Attorney General to the Legislative Assembly of 1882, Page 7.

¹³ Report of the Attorney General (for the biennial period ending December 31, 1897) Pages 41, 42, from report by L. M. Baldwin, Sheriff of Maui.

¹⁴ Report of the Attorney General (for the period ending December 31, 1899) Pages 44, 45, from "Report of the Adjutant of the Citizens' Guard."

in good working order, and are in a position to be called upon at a moment's notice to check any trouble or uprising that may occur at any time amongst the ever increasing number of Asiatics continually arriving in the Islands to supply needed labor for the many new plantations now in course of development.

The moral effect upon the Asiatics of having a body of thirty or forty white men well armed and commissioned as Special Police Officers ready at all times, has without doubt been the means of saving a great deal of trouble.

Even when investigation revealed just complaints on the part of the laborers, criminal prosecution and deportation followed attempts to protect themselves.

In the 1897 Report of the Bureau of Immigration,¹⁵ Wray Taylor, Secretary of the Board reported:

On April 21, 1897, I visited Lihue Plantation, Kauai, for the purpose of investigating causes that led up to a riot there, and which resulted in the death of a Chinese contract laborer, and the arrest of fifteen others on a charge of rioting. Mr. Goo Kim, the Chinese Commercial Agent, had previously made a complaint that the Chinese laborers were not treated well at Lihue and requesting an investigation.

I spent two days at Lihue thoroughly enquiring into the matter, and on my return, requested that the head luna, Mr. Zoller, be discharged at once and that Manager Wolters be reprimanded and held to strict account for the better treatment of the laborers in the future. This was done and since then no further complaints have come from Lihue. Fifteen ring-leaders in the riot were by order of the Court, returned to China.

The *Planters' Monthly* in September, 1890, reports that Japanese plantation labor upon arrival were registered at the Japanese Consulate and received numbers. The *Planters' Monthly* spoke with satisfaction of the assistance rendered by Japanese Consulate representatives. "He may run away from Kauai and go to Hawaii, but sooner or later the Japanese officials will find out where he is and send him back to his employer."¹⁶

In October of the same year, the *Planters' Monthly* hailed as a successful experiment the plan of having the Planters' Labor & Supply

¹⁵ Report of the Bureau of Immigration for the Biennial Period Ending December 31, 1897, Pages 8, 9, by Wray Taylor, Secretary of Board of Immigration.

¹⁶ *Planters' Monthly*, 9:390, September, 1890.

Co. (predecessor of the Hawaiian Sugar Planters' Association) pay the salaries of two special policemen appointed by the Board of Immigration "to seek out and arrest the deserters."¹⁷

The Report of the President of the Bureau of Immigration to the Legislature of 1892 reports a "riot at Kohala" on August 24, 1891:¹⁸

About 200 and more Chinese rioted against planter L. Asen because of illegal deduction of \$5.50 from \$15.00 monthly wages. No arrests, though there was a real riot and Deputy Sheriff Pulaa was in danger of being killed.

They then all went to Kapaau, met other Chinese there, increasing their number to 300 or more.

. Another riot commenced and orders were given to natives to arrest the Chinese, and 55 were locked up. They were prosecuted for battery on Government officers. A *nolle prosequi* was entered by Deputy Sheriff Williams and that was the end of it.

That there was no such thing as a legal strike in Hawaii is implied in a Report of the Sheriff of Kauai included in the Attorney General's 1895 Report:¹⁹

I would recommend . . . that four new cells be added to the Prison at Lihue. Here there is ordinarily room enough, but when labor strikes occur on the plantations large numbers of men are sometimes sent in at one time, and then the prison is greatly overcrowded.

D. Separation of Race as a Means of Controlling Labor

That the planters found it easier to control disturbances by hiring different races is indicated in a letter from H. F. Glade and F. M. Swanzy, a committee appointed by the Planters' Labor and Supply Company, set forth in the 1894 Report of the President of the Bureau of Immigration:²⁰

¹⁷ *Planters' Monthly*, 9:449, October, 1890.

¹⁸ Report of the President of the Bureau of Immigration to the Legislature of 1892, Pages 74-79.

¹⁹ Report of the Sheriff of Kauai, S. W. Wilcox, dated December 27, 1895, contained in Report of the Attorney General (for the period ending December 31, 1895, Page 75).

²⁰ Letter from H. F. Glade and F. M. Swanzy, Committee Appointed by P. L. & S. Co., January 9, 1894, Biennial Report of the President of the Bureau of Immigration (1894), Pages 8-12. (The same report, Page 8, reports considerable trouble among Japanese laborers, particularly on Kauai.)

... when the planter is entirely restricted to Japanese for his labor, employing, as some of them do, on one estate, 800 to 1,000 men. . . . they become a menace, showing a disposition to get exacting and quarrelsome, and if disposed to make a "strike" could produce results very disastrous to the plantation

... a single nationality of labor on a plantation is objectionable.

E. Grievances of Contract Labor

Dr. Charles A. Peterson, Inspector of Immigrants, summarizes the grievances of contract labor in his 1899 Report:²¹

The grounds of complaint have been corporal punishment, abusive language, unjust retention of pay, overtime and Sunday work and minor trivial matters.

There have been found cases of personal castigation, of brutal and abusive overseers, of the docking system carried to the limit, undoubted extension of hours and compulsory Sunday labor.

F. Plantation Strikes of 1900

Apparently the first successful strike in the history of the Territory took place at Pioneer Mill, Lahaina, Maui, from April 4, to April 13, 1900. The immediate cause of the strike was the fear that with annexation and the prospective discontinuance of the contract labor system, the workers would not receive the \$2.50 monthly bonus to which they were entitled under their contracts. Dr. C. A. Peterson, Inspector of Immigrants, gives us this description of the Lahaina strike:²²

The strikers for ten days continued to meet, to parade the town under Japanese flags, to drill and even, unhindered by any one, demolished the house and property of a store clerk who would not give them credit. The town was terrorized by their threats and presence. Not a warrant was sworn out or any move made to restrain them. Finally, Manager Ahlborn assented to their demands and agreed to discharge the Luna, time-keeper,

²¹ Report of Dr. Charles A. Peterson, Inspector of Immigrants, "Report of the Bureau of Immigration for the Biennial Period Ending December 31, 1899," Page 44.

²² File 51, Interior Department, Archives; report of Dr. C. A. Peterson, Inspector of Immigrants, MS.

doctor, and interpreter, to pay \$500.00 to the Consul for the relatives of each of (three) victims of the accident, to allow a nine-hour work day and to pay ten cents per hour for extra work, to pay the accumulated \$2.50 bonus immediately and employ the interpreter they wished.

Dr. Peterson reports that a successful strike at Olowalu occurred during approximately the same period.

The planters broke a strike at Kihei, Maui, occasioned by the two previous successful strikes. According to Dr. Peterson, the Kihei strikers:²³

. . . herded into Wailuku. There, on a charge of leaving work they were fined and ordered back to work and upon refusal many were employed on the roads . . .

A 1901 Laundrymen's Strike reported in the July 10, 1901 issue of *The Hawaiian Star* resulted in the issuing of a warrant for arrest of sixteen strikers for conspiracy for inducing others to stop work. The *Star* reports:²⁴

Judge Gear issued a warrant today for the arrest of sixteen Chinese on charges of conspiracy. The warrant was made on the complaint of Chu Fun, a laundryman on Liliha Street. This warrant was issued as the outcome of the present strike of Chinese washmen, which is still in progress.

According to the statements of the complaining witness the Chinese workers have banded together for the purpose of compelling the proprietors of wash houses to employ only members of their union and to pay these employes such prices as they demand. Chu Fun employs eight men but the union succeeded in inducing them to stop work with him and join their forces. The result was that Chu Fun's business, under the name of Kim Sing, was badly crippled.

II. CONDITIONS OF LABOR AFTER ANNEXATION

A. Civil Rights

But annexation, the abolition of contract labor, and the extension of the protection of the Constitution of Hawaii did not eliminate the troubles of plantation labor.

The third report of the Commissioner of Labor on Hawaii in 1905

²³ *Ibid.*

²⁴ *The Hawaiian Star*, July 10, 1901.

at Page 141 recognizes the continued violations and disregard of civil rights:²⁵

The old custom and the habit of regarding Japanese and other Orientals as people of inferior civil status as compared with whites still prevail in Hawaii and manifest themselves in a hundred unconscious acts on the part of the managers and overseers, who have never considered that in the strict letter of the law residents of a foreign country domiciled within our territories have the same rights to protection of person and property and to privacy and respect as ourselves. At the time of the Lahaina strike (late in May, 1905), militiamen and police went in squads to the rented quarters of the strikers in the town of Lahaina—not upon the plantation itself—entered without ceremony or shadow of legal right and roused the inmates, using persuasion that came but little short of force to get them out to a conference which the management desired to hold with the men and which they, in the exercise of their rights, declined to attend. One of the most liberal and progressive managers in the Islands spoke with lively resentment of the criticism made by a judge of an act of one of his overseers, who had without legal authority or warrant forced open the door of a house occupied by Porto Rican laborers suspected of theft, dragged the occupants from their bed, and discovered stolen property in their possession.

B. 1909—Japanese Strike

Fortunately, the 1909 Japanese strike is rather fully reported in the remarkable case of *Territory of Hawaii v. Soga*, 20 Haw. 71, sustaining a conviction for conspiracy against the leaders of the Higher Wage Consummation Association. The charge was concerting together “to do what plainly and directly tended to incite and occasion offense and to do what was obviously and directly injurious to another” by conspiring to prevent certain corporations owning sugar plantations in the County of Honolulu from carrying on their business and operating their plantations, and thereby impoverishing them by preventing them from carrying on their trade or business. The means charged were threats of violence directed against the corporations and all Japanese in the City and County who did not join with the Higher Wage Association.

The evidence in support of the threats of violence, were articles appearing in a Japanese newspaper, the *Nippon Jiji*, in support of the

²⁵ Third Report of the Commissioner of Labor on Hawaii, 1905, Page 141.

Association which urged "sticking together" to secure higher wages, "whatever the consequences," and other implied threats, which the conspirators did not denounce; letters received by leaders from members of the Association counseling force, which letters were procured from a safe stolen from one of the conspirators with the assistance of the police; a draft of a play attacking an opponent of the strike—likewise found in the stolen safe; and speeches made by the conspirators "intended to stir up the laborers."

The demands of the Japanese strikers formally presented to the Hawaiian Sugar Planters Association in January, 1909, were equal pay with Portuguese and Puerto Rican workers doing the same kind of work. At the time the strike began on May 10, 1909, the Japanese workers were receiving eighteen dollars a month for twenty-six working days or approximately sixty-five cents a day. Portuguese and Puerto Ricans doing the same work were receiving twenty-two dollars and fifty cents, better housing and an acre of land to till.

From the outset the daily press referred to the strikers as conspirators. Thus, the *Pacific Commercial Advertiser* carried the headline on the beginning day of the strike, "High Wage Conspirators Stir Up a Strike at Aiea Plantation." The same paper on May 20 carried an editorial entitled "What is Back of the Strike."²⁶ The editorial insisted that everyone was contented until the leaders of the strike:

... stirred up rebellious blood among the more ignorant coolies and these, in turn, have compelled the intelligent Japanese to side with them. Success of the strike would mean establishment of a labor oligarchy the planters would have to deal with thereafter; and to keep it from ordering strikes on any and every pretext they would be forced to subsidize it heavily. Blood money from the planters and dues from the laborers would give the hui the income of a bank; and with such buying resources it could even cut a figure in politics and legislation. No one can estimate what harm to the business community might finally result.

The strike spread despite the universal attack on the strike and its leaders. The *Pacific Commercial Advertiser* reported on May 25 that the plantations were continuing operations with seven thousand men out.^{26a} Strike breakers were paid a dollar fifty a day^{26b}—eighty-five

²⁶ *The Pacific Commercial Advertiser*, Walter G. Smith, Editor, May 20, 1909.

^{26a} *Ibid*, May 25, 1909.

^{26b} *Ibid*, June 2, 1909.

cents more per day than the Japanese workers were earning at the beginning of the strike, and almost double what their demands were.

On June 10, eleven strike leaders were arrested and held in jail for investigation, although no charges were preferred against them.^{26c} The next day an attorney for the strikers by the name of Lightfoot applied to Circuit Court Judge Robinson for a writ of habeas corpus, but the writ was denied.^{26d}

At the time of the hearing, the *Advertiser* reports about fifteen hundred Japanese gathered in front of the Judiciary Building, and that:

A warning was given the Japanese last night that their demonstrations before the Judiciary Building were not to be allowed any more. Handbills in Japanese were distributed by the deputies of the High Sheriff, *drawing attention to the law regarding unlawful assemblies* and stating that there was no need of the entire Japanese population of the island assembling at the Judiciary Building. It was promised that seats for forty Japanese would be reserved in the court room during the trials of the leaders and that no more than forty would be necessary to see that the trial was conducted fairly.^{26e}

The strike leaders were finally released on bail after charges of disorderly conduct and conspiracy were preferred against them. W. A. Kinney of the law firm of Kinney, Ballou, Prosser & Anderson, attorneys for the planters who were made counsel of record assisting the prosecution on the motion of Attorney General Hemenway, protested the release of the prisoners on bail. According to the *Advertiser*:^{26f}

Kinney declared that the power existed in the discretion of the court to remand the prisoners without bail, even if they were only held as witnesses. He said that the opinion of the Attorney General should be sufficient foundation for the court refusing bail, it being plain that the interests of justice would be defeated by allowing the witnesses to go free and be influenced by the threats of others. . . . It is a criminal organization that we have to deal with and if these men are allowed to be bailed out as soon as arrested it will soon become a question as to where the Government actually is.

^{26c} *Ibid*, June 11, 1909.

^{26d} *Ibid*, June 12, 1909.

^{26e} *Ibid*, June 12, 1909.

^{26f} *Ibid*, June 13, 1909.

Red-baiting, modern style, was introduced by the *Advertiser* in a June 14 editorial entitled "False Sympathy for the Strikers":²⁷

We further believe that there is altogether too much encouragement given the Japanese strikers by a number of white residents of this city, citizens radically socialistic in their views and ready to defend and to justify violation of the laws framed for the protection of capital. . . .

By June 17, fifty-five indictments by the Territory and one by the United States^{27a} had been returned against the strikers, a majority of them being conspiracy charges.^{27b}

On July 9, Circuit Court Judge Robinson issued an injunction against the *Nippu Jiji* ordering it to put an end to articles that included threats of boycott or ostracism, and thirty-three strike leaders were enjoined from committing any acts of violence described in the complaint and from picketing places where employees of the Oahu Sugar Company and other Japanese laborers frequented for the purpose of intimidating them.

When the pickets were orderly, they were described as "military" and enforcing a court-martial system against violators of the association's prohibition against force. "The system," the *Advertiser* reports, "has become so perfect that it has practically stopped desertions to the sugar fields."²⁸

²⁷ *Ibid*, June 14, 1909. At this time there was no organization of socialists in the Territory. However, in 1912, a Socialist party was organized in the Territory. Its secretary, Mr. Julius Rosenstein who still resides in Honolulu, informed the writer that he was subpoenaed to appear before the grand jury in 1912 and asked whether he had communicated with Samuel Gompers and informed him that workers in the Territory of Hawaii were living in a state of peonage. He denied that he had ever been in communication with Mr. Gompers, although he indicated to the grand jury that he felt the substance of the statement was in accord with the facts.

^{27a} *Ibid*, June 4, 1909. According to the *Pacific Commercial Advertiser*, Ochiyama, a strike leader at Kahuku, was arrested by the United States Marshal on June 3. "His offence," according to this issue of the *Advertiser*, "consisted in having gathered up a number of copies of the *Hawaii Shinpo* (an anti-strike Japanese paper) and mailed them back to Editor Sheba with the word 'traitor' written conspicuously across them."

^{27b} *Ibid*, June 17, 1909.

²⁸ *Ibid*, July 15, 1909.

The *Advertiser* on July 20 castigated a jury and branded the jury system as a venerated humbug following a hung jury on a riot charge against five Japanese strikers from Waipahu:²⁹

The guilt of the prisoners seemed clear to those who heard the evidence impartially. Yet there was a mistrial because a number of the jurymen were hostile to the sugar corporations and did not care how much they might be embarrassed by the strike. They did not attempt to deal justly. They simply wanted to "do" the planters.

It was further suggested in the same *Advertiser* that an investigation would probably be made of the conduct of the jurors.

The *Advertiser* reports on September 14 that it was difficult to get a jury in the second trial of the riot case. The jury finally impaneled on September 11 consisted of eight whites, three part Hawaiians and one Hawaiian; after a fourteen day trial the jury deliberated twenty-six hours and failed to agree.

The *Advertiser* on September 29 reports:³⁰

"RIOT JURYMEN FAIL TO AGREE—Deliberated Twenty-Six Hours—Defendants Go Free.

"The jury was hung by one man, said to be Joseph I. Whittle, a painter, who announced that he would not give in if the jury were kept out a year. He voted throughout for acquittal and is said to have devoted most of his time to making disparaging remarks about the sugar planters."

The strike was lost and the Association voted to return to work with no wage increase on August 5, 1909.

C. Interference by Planters and Government With Right of Free Labor to Leave

By 1905 the sugar planters were pretty much disillusioned about the docility of Japanese laborers. In 1906 the importation of Filipino laborers began.

A striking picture of the violation of civil rights of Filipino workers by the legislature and the courts is described by Ray Stanard Baker in the *American Magazine* for January, 1912, entitled

²⁹ *Ibid*, July 20, 1909.

³⁰ *Ibid*, September 29, 1909.

"Human Nature in Hawaii; How the Few Want the Many to Work for Them — Perpetually, and at Low Wages:"³¹

The planters, indeed, have now reached the point where they are willing to employ all the devices of legislation, not only to get laborers, but to force them to remain in the islands. Of the methods pursued under the leadership of one of the foremost lawyers of the islands, Mr. W. A. Kinney, I had a vivid illustration just as I was leaving Honolulu (spring of 1911). Quite a number of Filipinos had purchased tickets and were about to depart for California. Just before sailing, officers came aboard and arrested several of these men and took them ashore with their bags and belongings. The same methods were pursued in the case of another ship which departed on the same day. Blacker looks of anger and disappointment I have rarely seen on men's faces than I saw on the faces of these men.

I made immediate inquiry and found that these men were not wanted for any crime or misdemeanor whatever, but were arrested *as witnesses* to appear against an immigration agent who was in Hawaii recruiting laborers for Alaska, just as agents of Hawaii have long been in other countries recruiting laborers. Of course, it was a mere barefaced device to prevent the Filipinos from getting away from Hawaii.

A few days later, it was discovered that a vessel—the *Senator*—had come to the islands especially to take away workmen—mostly Filipinos. A man named Frank Craig, an immigration agent, although he held a license from the Territory, was arrested and locked up. Then the planters' interests went to the legislature, which was then in session, and demanded the passage of a new and stronger law to prevent the activities of immigration agents. In the meantime the *Senator* hovered in the offing like some pirate vessel. A large number of Filipinos were there and wanted to go. They were free men, and yet they were watched and detained by the authorities. Nevertheless, a hundred or more of them escaping the vigilance of Mr. Kinney and his forces, embarked in small boats in the night and succeeded in reaching the *Senator* and in sailing for San Francisco.

Of course, the planters felt aggrieved; they had paid high prices for bringing in the Filipinos and they needed workmen—but this was a plain, bold attempt to constrain the rights of free men by the use of the machinery of the law.

³¹ Ray Stannard Baker, "Human Nature in Hawaii; How the Few Want the Many to Work for Them—Perpetually, and at Low Wages," *American Magazine*, January, 1912, Pages 328-339.

In the meantime the legislature was being pressed to pass immediate laws to prevent the recurrence of any such incident as that of the *Senator*. The following law was finally enacted:

Any person who, by promise of employment outside the Territory of Hawaii, shall induce, entice or persuade, or aid or abet in inducing, enticing or persuading, any servant or laborer who shall have contracted, either orally or in writing, to serve his employer for a specific length of time to leave the service of said employer during such time without the consent of said employer, shall be guilty of a misdemeanor and upon conviction thereof shall be punished by a fine of not more than five hundred dollars, or by imprisonment for not more than six months, or by both such fine and imprisonment.

First, tangle the ignorant workman up with a contract "oral or written" and then make it a criminal offense to offer him a better job outside of Hawaii than he has in Hawaii! Already a young Filipino named Alvarado has been sentenced to a year in prison for offering employment in California to working people in Hawaii.

Unwilling to pay more wages to keep their laborers, the planters are thus using their control of the machinery of the law to force the laborers to remain. How does this differ in principle from serfdom?

The complacency with the "serfdom" that Mr. Baker found shocking is apparent in a March 31, 1911 article in the *Pacific Commercial Advertiser*:³²

Sheriff Jarrett has a pile of subpoenas he cannot see over to serve upon Filipino witnesses wanted to testify in the charge brought by the Territory against de Gussman, being investigated by the Grand Jury on allegations that he is soliciting labor here without a license. The sheriff tried to serve the paper yesterday but was prevented by the laws of quarantine.

The Filipinos wanted are among the number being held in detention by the federal quarantine officers in order that they may qualify as outgoing steerage passengers today on the Korea. If the Sheriff and Harry T. Lake, who is assisting him, had been admitted among the quarantined bunch, the requisite guarantee that none of the steerage possibilities had come into contact with Honouliulans could not be issued by the health authorities.

³² *Pacific Commercial Advertiser*, March 31, 1911, Page 1.

The delay in serving the summons to appear and testify will not be of any particular benefit to the expectant labor recruits for California, however, as they will be attended to as soon as they are turned over to the Pacific Mail officials today for shipment. Honolulu will be blest by their presence for some little time to come.

Yesterday, twelve Filipinos were committed to Judge Lymer for having disregarded their grand jury summons and will meditate over the intricacies of American law for a few days in the bastille.

After the subpoenas now issued are served, there will be in the neighborhood of three hundred witnesses to be examined in the de Gussman case.

That the sugar planters or their representatives in the legislature were not disposed to reform voluntarily is indicated by a report contained in the Pacific Commercial Advertiser for March 3, 1921:³³

On recommendation of the judiciary committee three house labor bills, introduced by Representative Lorrin Andrews at the request of the Central Labor Council, were tabled in the senate at yesterday morning's session. They were:

H.B. 31, seeking to prohibit employers from coercing employees in the purchase of things of value.

H.B. 35, to provide for the furnishing of service letters by public utility corporations to employees leaving their services.

H.B. 36, providing that any public service corporation employing spotters shall, before disciplining or discharging any employee, accord a hearing to such employee.

D. 1920 Japanese and Filipino Strikes

The general unrest of labor in the United States following World War I affected Hawaii also.

In 1919 the Japanese organized a series of labor organizations on the various islands and late that year combined them into the Federation of Japanese Labor in Hawaii. The Filipinos formed a Filipino Labor Union.

In December, 1919, the Japanese Federation formalized its grievances in a resolution submitted to HSPA. It read:

³³ *Pacific Commercial Advertiser*, March 3, 1921, Page 1.

We are laborers working on the sugar plantations of Hawaii. People know Hawaii as the Paradise of the Pacific and as a sugar producing country, but do they know that there are thousands of laborers who are suffering under the heat of the equatorial sun, in field and factory, and who are weeping under 10 hours of hard labor and with the scanty pay of 77c a day?

Hawaii's sugar! When we look at Hawaii as the country possessed of 44 sugar mills, with 230,000 acres of cultivated land area, as a region producing 600,000 tons of sugar annually we are impressed with the great importance of the position which sugar occupies among the industries of Hawaii. We realize also that 50,000 laborers who, together with their families number about 160,000, are a majority of the 250,000 total population of Hawaii. We consider it a great privilege and pride to live under the Stars and Stripes, which stands for freedom and justice, as a factor of this great industry, and as a part of the labor of Hawaii.

We love production. Fifty years ago, when we first came to Hawaii, these islands were covered with ohia forests, guava fields, and areas of wild grass. Day and night did we work cutting trees and burning grass, clearing lands and cultivating fields until we made the plantations what they are today. Of course, it is indisputable that this would have been impossible if it were not for the investments made by the wealthy capitalists and the untiring efforts of the administrators. But we believe that the impartial public will not only magnify and praise the efforts of the capitalists, but will not hesitate to recognize the work of the laborers who have served faithfully with sweat on their brows. We are faithful laborers who love labor and production.

Look at the silent tombstones in every locality. Few are the people who visit these graves of our departed friends, but are they not emblems of Hawaii's pioneers in labor? Turn your eyes to the ever diligent laborers. They are not beautiful in appearance, but are they not a great factor of Hawaii's production?

We are faithful laborers, willing to follow the steps of our departed elders and do our part towards Hawaii's production. We hear that there are in Hawaii over 100 millionaires, men chiefly connected with the sugar plantations. It is not our purpose to complain and be envious, but we would like to state that there are on the sugar plantations which produced these fortunes for their owners a large number of laborers who are suffering under a wage of 77 cents a day.

When asked, "What is a laborer?" a certain plantation manager is said to have replied, "A laborer is an ignorant creature."

We do not wish to believe such a statement, but when we look back over our own experience in Hawaii, we regret to state that the above fact is undeniable.

Impartial and just ladies and gentlemen, we are laborers working on the plantations of Hawaii. Certain capitalists may regard us as ignorant creatures, but as laborers working seriously and faithfully we wish it understood that we are willing to do our part toward Hawaii's production and welfare as best we know how, hoping for the progress of civilization and endeavoring to safeguard justice and humanity as members of the great human family.

The resolution was accompanied by a list of demands which included:

1. An increase from 77c to \$1.25 a day. Women laborers to receive a minimum of 95c a day.
2. The bonus system to be made a legal obligation rather than a matter of benevolence.
3. An eight-hour day.
4. Maternity leave with pay for women two weeks before and six weeks after birth.
5. Double-time for overtime, Sundays and holidays.

These demands were first submitted to the Hawaii Sugar Planters Association on December 4, 1919. They were flatly rejected.

The workers sent two representatives to discuss their grievances with the Hawaii Sugar Planters Association but were refused an interview.

On January 19, 1920, members of the Filipino Laborer's Association went on strike on six Oahu plantations. This organization also contained large numbers of Chinese, Portuguese and Spanish workers. Four days later, the Japanese workers struck. The workers' publication summarized the viewpoint of the strikers:

The door was closed before our eyes; there was no more room for negotiation. The time had finally come when we were compelled to resort to our last means.

For two months, ever since our first request, we had been pleading our cause sincerely, honestly, seriously and earnestly without a thought of plot or scheme. We had tried every peaceful method we knew of, with the hearty cooperation of capital and labor in mind. We do not wish to strike. We want peace and order; we love labor and production. But when we think

of the group of capitalists who show no sympathy whatever toward the struggling laborers, turn deaf ears to their cries and reject their just and reasonable demands under the pretense that they are formulated by "agitators," we cannot remain silent. We must act. And so we went on strike. . . . So, strike we did, honorably and bravely, as laborers living under the great flag of freedom and justice. We were obliged to strike. This is a strike we disliked, a strike we tried to evade. We trust that the unprejudiced will find out the true source wherein the fault lies before forming any judgment.

"An American citizen who advocates anything less than resistance to the bitter end against the arrogant ambition of the Japanese agitators is a traitor to his own people," the *Honolulu Star-Bulletin* editorialized .

On February 14, the planters issued an eviction notice ordering "every laborer unless sick or for other good reasons is unable to work, to be at his place of employment next Wednesday morning, February 18, or otherwise, to leave the plantation upon which he has been employed forthwith."

When the workers failed to vacate, the planters sent guards who forcibly evicted the strikers, and removed their belongings from the company houses. Twelve thousand and ten people were evicted. Of these, 1,472 were Filipinos. Five hundred and thirty-eight Japanese were evicted. Of the total number, 2,643 were women, and 3,856 were children.

In February, 1920, Honolulu was in the midst of an influenza epidemic. The epidemic spread to the strikers who were living in temporary shelters with inadequate sanitary facilities. Before the epidemic passed, about 1,200 strikers and their families died from influenza.

Estimates are that the Hawaii Sugar Planters Association spent \$12,000,000 fighting the strike; the Japanese Federation received in strike assessments and contributions \$681,499.

Immediately after the end of the strike, the Hawaii Sugar Planters Association made efforts to import coolie labor to the islands to supplant the Japanese and Filipino workers.

George Wright, speaking for the Honolulu Central Labor Union, told the Congressional Committee, in opposition to the coolie importation, that there was no labor shortage, but rather that men

had been driven from the plantations by intolerable conditions and were still available if the planters would pay them a living wage. He also testified that the charges of nationalism against the Japanese in the 1920 strike had no basis in fact but that the issue was entirely economic.

In a hearing before Congress, Royal D. Mead, secretary of the Hawaii Sugar Planters Association said:

. . . The Territory of Hawaii is now and is going to be American; it is going to remain American under any condition and we are going to control the situation out there. . . . *The white race, the white people*, the Americans in Hawaii are going to dominate and will dominate.

Congress refused to pass legislation permitting the planters to bring in coolies. The Hawaii Sugar Planters Association returned to the Philippines for its labor supply.

During the strike, on August 1, 1921, twenty-one strike leaders were indicted for conspiracy to dynamite the house of J. Sakamaki, an outspoken opponent of the strike. The incident had occurred on June 3, 1920, shortly before the termination of the strike. Four of those indicted were not apprehended. The case against the two who turned state's evidence were nolle prossed. The fifteen remaining were convicted and sentenced to serve a minimum of four and a maximum of ten years. An appeal by way, of a bill of exceptions, was taken to the Supreme Court of the Territory. The case is reported in 27 Haw. 65.³⁴ The fifteen convicted were, with one or two exceptions, as appears from the court report, top leaders of the Union on Oahu and Hawaii.

The testimony introduced showed that only Murakami, Saito and Matsumoto actually participated in placing the dynamite under Sakamaki's house. No loss of life occurred but the house itself was damaged. Two of the three alleged conspirators, Saito and Matsumoto, testified for the government. They claimed that the Union failed to pay them a promised \$5,000. A third government witness, who was not indicted, testified that he procured the dynamite. The court, although it conceded several errors of the trial court, found none of them prejudicial.

³⁴ *Territory v. Goto, et al.*, 27 Haw. 65.

The appeal being by bill of exceptions rather than writ of error, no appeal lay to federal courts. A petition for a writ of habeas corpus was denied by the Federal District Court for the District of Hawaii. That denial was upheld by the United States Supreme Court in *Goto v. Lane*, 265 U.S. 393. (See Note 1 of the memorandum.)

E. 1924 Filipino Strike

The 1924 Filipino Strike hit a new high in arrests and criminal prosecutions. The following summary of the strike appeared in *The Hawaiian Annual for 1925*:³⁵

An unjustifiable strike movement of Filipino laborers, the result of designing agitators, began April 1st on some of the Oahu plantations, and gradually affected certain others on the other islands. By the middle of August the discontented and intimidated idlers numbered some 1600 at all points, with threatening aspect at Hilo, Lahaina, Kalihi, and Kapaa. September 9th the strikers precipitated a riot at Hanapepe, Kauai, resisting police rescue of the two intimidated men held in the strikers' camp, in which four policemen and sixteen Filipinos were killed, and a number of others wounded. The rioters were finally overcome and arrested, and on trial, sixty of the seventy-six participants were sentenced each to a four-year prison term, the ringleaders all being beyond pale of earthly courts.

Pablo Manlapit and Cecil Basan, prominent strike agitators, were sentenced September 27th of subornation^{35a} of perjury, and each sentenced to two years in jail.

Denunciation of the strike leaders and of their sympathizers among the Japanese editors and elsewhere, by the English press, was violent, particularly after the Hanapepe incident. *The Star-Bulletin*, for example, editorialized on September 11, 1924:^{35b}

³⁵ *The Hawaiian Annual for 1925*, Pages 126-127.

^{35a} According to the *Honolulu Star-Bulletin*, September 10, 1924, Manlapit and Basan were charged with subornation of perjury for soliciting the father of a child who died to say that the child was "ejected" from Waipahu Plantation Hospital, and publishing the story in the Filipino newspaper edited by Basan as propaganda against the planters five days after the strike began. The plantation doctor, it is stated, advised the parents that the child was too ill to move, but they did not follow his advice and the child died.

^{35b} *Honolulu Star-Bulletin*, Sept. 11, 1924, Riley H. Allen, Editor.

Besides the soft-handed and soft-living Filipino "leaders" of the Manlapit type, and besides the Japanese who are encouraging the Filipinos and hoping the strike will win, there is a heterogeneous group of "red," "pinks," and "yellows"—"wobblies" and communists and crack-brained demagogues—who have aligned themselves with the strikers and are doing their bolshevik best to turn Hawaii into anarchy.

We state that issue again: one one side, law-abiding Americanism; on the other side, criminal labor conspiracy and violence, alien nationalist support, "red" agitation and anarchistic propaganda.

The Hanapepe incident took place on September 9; four policemen and sixteen strikers were killed.^{35c} One hundred and thirty-three Filipinos were arrested, of whom seventy-six were indicted for rioting. The remaining forty-seven pleaded guilty to charges of assault and battery and were released under thirteen months' suspended sentence. On October 10, four of the seventy-six pleaded guilty of rioting and seventy-two not guilty.^{35d}

The trial of the seventy-six was held in the Circuit Court of the Fifth Judicial Circuit at Lihue, Kauai, Judge William C. Achi presiding. The jury deliberated seven hours. Two defendants were sentenced to four years and eleven months for rioting; fifty-eight to four years; sixteen were acquitted.^{35d}

Early in the strike, Cecilio Basan, editor of the Filipino paper supporting the strikers, and a Gregorio de la Cruz were arrested on charges of malicious burning of a cane field. De la Cruz was held fifty-four days in the county jail for "investigation" by Detective Chief John R. Kellett. On October 18, they were found guilty of malicious burning in the third degree.^{35e} Basan was sentenced to hard labor for a term of from three years six months to five years; De la Cruz for a term of five years.^{35f}

According to the *Star-Bulletin* of September 13, 1924, special prosecutors paid by the planters were sent by the Attorney General's office to Hawaii to prosecute violations of law which occurred on that island:^{35g}

^{35c} *Honolulu Star-Bulletin*, September 9, 1924.

^{35d} *Ibid*, September 23 and October 10, 1924.

^{35a} *Ibid*, November 8, 11, 1924.

^{35e} *Ibid*, October 20, 1924.

^{35f} *Ibid*, editorial, October 23, 1924.

^{35g} *Ibid*, September 13, 1924.

Owing to the lack of sufficient funds, the territorial government has been forced in the present emergency to accept the support of the Hawaiian Sugar Planters' Association for the payment of the special prosecutors involved.

Three strikers on Hawaii were arrested and charged with violating the anti-picketing ordinance passed by the Legislature the preceding year. One was convicted in the District Court at Honokaa, and two were discharged. The appeal of the convicted striker to the Circuit Court resulted in a mistrial.^{35h}

Four strikers were charged under the criminal syndicalism act, according to the *Star-Bulletin* of September 30; these four had allegedly used threatening language at a strike meeting saying, "The face of the earth would flow with blood. They call Filipinos 'poke-knife.' We will show them the Filipinos who are called 'poke-knife'."³⁵ⁱ

They were acquitted by a jury.

F. Organization—1924 to 1937

From 1924 to 1937, no notable or sizeable strikes of plantation labor occurred. That the plantation attitude toward labor did not change during this period of "labor peace" is illustrated by a statement made in 1929 by R. A. Cooke, president of the Hawaii Sugar Planters Association.

As has been emphasized again and again, the primary function of our plantations is not to produce sugar but to pay dividends.

The following year, he said:

I can see little difference between the importation of foreign laborers and importation of jute bags from India.

The reason for lack of labor organization during this period, according to William Crozier, Territorial House of Representatives, as told a special sub-committee of the Legislature, was:

Any working man who tries to organize and bargain collectively to better the condition of himself, wife and children, is

^{35h} *Honolulu Star-Bulletin*, September 30, 1930.

³⁵ⁱ *Ibid*, September 24, 1930.

looked upon as a communist, a radical, a socialist and a red ... The Employers discharge men for joining Unions in Hawaii.

G. 1937 Maui Filipino Strike

In 1937, an organization of Filipino workers, the Viboro Luvi-minda, led by Antonio Fagel, struck at Puunene, Maui. About a thousand workers began the strike in April, but before the strike ended in July, the strikers were joined by approximately three thousand more Filipino field workers on Maui.

On May 19, the *Star-Bulletin* reports the issuing of warrants for the arrest of Antonio Fagel and nine other strikers. According to that paper they were:³⁶

... charged with conspiracy to commit unlawful imprisonment. Authorities who swore out the warrants charged five strikers, already under arrest, with seizing a non-striking Puunene worker and forcing him to accompany them to strike headquarters here (Wailuku) and sign a pledge to join the walkout. Fagel and four others were alleged to have been in strike headquarters at the time and to have obliged Anastasio Manangan to sign the statement.

On May 21, all but three were freed on \$200 bail. The trial began June 17, but was postponed a few days to allow Grover Johnson, International Labor Defense Attorney, to arrive. On June 23, Judge D. H. Case granted a change of venue to Honolulu, at the request of County Attorney Bevins, who based his motion on apparent inability of the court to obtain a jury to hear the trial. A jury was selected on August 10, 11 and 12. The trial began on August 17, and ended September 9. Judge H. E. Stafford granted a directed verdict of "not guilty" for one defendant, Macario Quicio. On September 9, Antonio Fagel, his chief aide, Florentino Cabe, and six others were found guilty of conspiracy in the third degree. All but Fagel received suspended sentences of thirteen months and a nominal fine. Fagel, however, preferred four months in the City and County Jail, saying, "If I am on probation, what is to prevent them from bringing me in court again?"

In the course of the trial, Judge Stafford excoriated Maui police

³⁶ *The Honolulu Star-Bulletin*, May 19, 1937.

methods and threw out the confession allegedly made. *The Voice of Labor* for September 2, 1934, reports:³⁷

Four confessions allegedly made by Filipinos on trial for the Maui strike were tossed out of court Thursday, after Judge H. E. Stafford had uttered a scathing denunciation of Maui police methods used in obtaining statements.

Admission of the confessions was strenuously objected to by Grover Johnson, ILD attorney, on the ground that they were obtained by inducement, fraud, intimidation and duress. The defense thereupon called each of the defendants to the stand, each of whom testified that they had been locked in dark cells at Wailuku for three days, that the cells were so dark they couldn't tell night from day. . . .

The defendants testified the cell was absolutely bare of any equipment and they were forced to lie upon the cement floor. After the long confinement, the exact duration of which was known by the men, they were taken from their cells and brought before a Filipino cop, Rafael Guanzon, who read their "confessions" in part and told them that if they signed they would be released but that if they didn't sign the statements, they would be returned to the dark cells until they did sign.

On September 9, the *Voice of Labor* reported:

Prosecution was handled by William Lymers who "in court admitted that he expected to present to the HSPA a bill for his services in the case."

H. Inter-Island Strike—The Hilo Massacre

The next year, 1938, in May, the seamen and longshoremen of the Inter-Island Steam Navigation Company struck for three months.

According to the *Star-Bulletin*, June 14, twelve strikers were arrested for investigation. Nine were booked for assault and battery, interfering with a police officer, and malicious injury.^{37a}

According to the *Hawaii Hochi* on June 15, one of the men, Domingo Saldana,

... was observed helplessly attempting to dodge a rain of "blackjack" blows by uniformed and special police officers, while being held in an armlock by other police.^{37b}

^{37b} *Hawaii Hochi*, June 15, 1938.

³⁷ *The Voice of Labor*, September 2, 1937.

^{37a} *The Honolulu Star-Bulletin*, June 15, 1938.

Five of the men were tried. One was convicted of assault and battery and Saldana got twenty days for damaging a car.

On August 1, an Inter-Island ship, the *S. S. Waialeale*, manned with a crew of strike-breakers, docked at Hilo to unload cargo. Preparations had been made by the police force to prevent the picketing of the vessel when it arrived. Barricades had been erected by the police and the assembled crowd was ordered to stay away from the vicinity of the dock. When the strikers and strike sympathizers began to picket, the police fired rifles into the crowd. Tear gas and bayonets were also used by the police. Fifty-one strikers and strike sympathizers were shot or bayoneted. Harry Kamoku, President of the Hilo Longshoremen's Union, said at the time:

They shot us down like a herd of sheep. We didn't have a chance. The firing kept up for about five minutes. They just kept on pumping buckshot and bullets into our bodies. They shot men in the back as they ran. They shot men as they were trying to help wounded comrades and women. They ripped their bodies with bayonets. It was plain slaughter.

The Attorney General of the Territory sent a special investigator to Hilo, Deputy Attorney General Edward N. Sylva. He issued a report, most of which was made public in the *Honolulu Star-Bulletin*, September 23.

During September, the Hawaii County Grand Jury also probed the affair. On September 20, the Grand Jury brought in a written report which read:

To the Honorable D. E. Metzger

We, the grand jury, duly impaneled to investigate the incident, which occurred at or near the Kuhio wharves and piers on August 1, 1938, after hearing all the evidence and after due deliberation, find that a state of emergency existed on that date and that said evidence is not sufficient to warrant an indictment against any person or groups of persons.

Judge Delbert E. Metzger, the Judge of the Circuit Court of the Fourth Judicial Circuit, of Hilo, according to the *Star-Bulletin* of September 20, stated from the bench when he received the report:^{37c}

^{37c} *The Honolulu Star-Bulletin*, September 20, 1938.

This report reads to me more like a policy committee of some civic organization than that of a grand jury. "We find a state of emergency existed." This does not seem to mean anything as a matter of legal term. It is a matter of public knowledge that several men were grievously injured by shooting, by stabbing, by broken jawbones, or something of the sort.

It seems rather strange to me that there was not any law violated by either one side or the other in an affray of that kind.

I. The Anti-Picketing Law

Picketing was prohibited by law in the Territory from 1923 until 1945, when the law was repealed by the territorial legislature. The law is the same type of law held unconstitutional by the Supreme Court of the United States in 1940 in the *Thornhill* and *Carlson* cases. In part the law provided:³⁸

It shall be unlawful for any person or persons, singly or conspiring together, to loiter about, beset, patrol or picket in any manner the place of business or occupation or any street, alley, road, highway or other place in the vicinity where such person may be lawfully engaged in his work.

That the law was invoked appears from the *Honolulu Star-Bulletin* of June 23, 1938:

Jury trial on charges of violating the territorial anti-picketing law was demanded today by thirteen men and women arrested on warrants sworn out by Lewis Perkins Williams, co-owner of the Rialto Beer garden. . . .

While the case was pending, an arrangement was made by the special assistant to the public prosecutor and the attorney for the Hotel, Restaurant and Bar Catering Association that two pickets might be permitted.

On July 21, 1938, Circuit Judge Le Baron rendered a decision upholding the law. The *Star-Bulletin* reported:^{38a}

Judge Le Baron's decision held that the territorial statute involved has not been repealed by the Wagner Act and the Norris-La Guardia anti-injunction law and is not modified by the federal anti-striking act.

³⁸ Revised Laws, 1945, Sections 11520 to 11522. The Law was repealed by the Legislature during the 1945 session.

^{38a} *The Honolulu Star-Bulletin*, July 21, 1938.

According to the same report, Judge Le Baron also held that:

... mere patrolling for the purpose of publicity of any or all phases of a labor dispute (without obstructing or injuring the lawful business of another) was lawful. But if the purpose of picketing is to destroy or smash the victim's business by shutting off his usual source of business patrons and by threats to force the owner of a business to as such pickets demand, it violates fundamental rights guaranteed by the Constitution and is clearly not peaceful picketing.

J. Labor and Martial Law

After December 7, 1941, martial law wiped out the civil rights of all people in the Territory, but particularly workers. Laborers were frozen to their jobs by order of the military governor. Plantation workers could not leave their jobs without the permission of their employers. A wage freeze was decreed.

In December, 1942, Garner Anthony, Attorney General of the Territory, submitted a report to Governor Stainback, attacking martial law. The Report states:

In place of the criminal courts of this Territory there have been erected on all the islands provost courts and military commissions for the trial of all manner of offenses from the smallest misdemeanor to crimes carrying the death penalty. Trials have been conducted without regard to whether or not the subject matter is in any manner related to the prosecution of the war. These military tribunals are manned largely by Army Officers without legal training. Those who may have had any training in the law seem to have forgotten all they ever knew about the subject.

Lawyers who appear before these tribunals are frequently treated with contempt and suspicion. Many citizens appear without counsel; they know, generally speaking, that no matter what evidence is produced, the "trial" will result in a conviction. An acquittal before these tribunals is a rare animal. Accordingly, in most cases, a plea of guilty is entered to avoid the imposition of a more severe penalty. Those who have the temerity to enter a plea of not guilty are dealt with more severely for having chosen that course.

Not until March, 1943, was military control relaxed. With this relaxation, labor organization began on the plantations. Apprentice mechanics were earning a base pay of 28¢ an hour, field hand 25¢, plantation clerks 19¢, skilled mechanics 82¢. Non-plantation un-

skilled labor was earning 82¢. In 1944, five longshoremen from Honolulu who were attempting to organize plantation workers were picked up by the Provost Marshal and ordered to return to Honolulu. They were threatened with a change in their draft status.

In twelve months, 20,000 mill and field laborers were organized.

Every National Labor Relations Board election for the mill workers was won overwhelmingly. The Union, the International Longshoremen's & Warehousemen's Union, received 97 per cent of the votes cast. On Maui, in 14 elections the vote was 2,243 for the International Longshoremen's & Warehousemen's Union to 219 against. On Kauai, in 11 elections, the vote was 1,709 for the union, 18 against. On Hawaii, in 29 elections, the vote was 3,138 for the union, 161 against. Typical returns were the ones at Lihue Plantation Co. where the vote was 679 for the International Longshoremen's & Warehousemen's Union, 4 against. At Koloa Sugar Co., it was 173 for the International Longshoremen's & Warehousemen's Union, 1 against.

K. 1946 Bus Strike Conspiracy

Late in June, 1946, a majority of the employees of the Honolulu Rapid Transit Company became dissatisfied with the handling of negotiations by the officers of their union, the Amalgamated Association of Street, Electric Railway and Motorcoach Workers, and formed a new negotiating committee. The company refused to recognize the new committee. *The Honolulu Star-Bulletin* of July 12, 1946, reports:

Three hundred and fifty HRT drivers voted to demand company recognition for a new negotiating committee, precipitating an intra-union dispute over negotiating authority. At eight this morning (July 12), the new committee told Governor Stainback there would be no strike, but drivers might not collect fares. At nine, HRT employees were told by A. A. Rutledge, chairman of the new negotiating committee, that the union would not instruct them to give free rides; that was up to individual drivers. Addison E. Kirk, president and general manager of HRT, warned that failure to collect fares violated territorial law and drivers caught giving free rides would be discharged.

A majority of the drivers, with the amused cooperation of the public, did not collect fares. Twenty-nine drivers were discharged

on July 12. The company ceased operating its busses because the drivers refused to state whether they would collect fares. After the twenty-nine discharged drivers were reinstated as a result of mediation of the dispute by representatives appointed by the governor, operations were resumed and fares collected.

On September 11, 1946, A. A. Rutledge and Henry Gonsalves, both officials of the Teamsters Union and advisers to the new union which had affiliated with the Teamsters union, Edward Collier, union president, George Kaisan, union secretary, and Henry Lopes and Manuel Dias were indicted for conspiracy. None of the twenty-nine employees who were discharged for failing to collect fares were indicted.

A challenge to the constitutionality of the conspiracy statute was overruled in June, 1947, and the trial began on July 24, 1947. On August 1, after twenty-one hours of deliberation, the jury returned a verdict of "not guilty" as to all defendants.

L. 1946 Sugar Strike

On September 1, 1946, after collective bargaining failed to produce an agreement, and after a vote in which 94 per cent of the ballots cast favored a strike, 25,000 sugar workers struck.

The demands of the strikers were:

1. A 65 cent minimum cash wage;
2. A 40 hour work week;
3. A union shop; and
4. A reduction in the cost of perquisites.

The strike lasted 79 days except at Pioneer Mill Company at Lahaina, Maui, where it continued until the first of the year until the Company agreed to arbitrate the discharge of ten strikers. These men were charged with criminal offenses, but not tried or convicted. The company discharged them for violation of Company rules for the alleged offenses involved in the criminal cases.

Except for twelve strikers on Kauai charged with the felony of contempt for violating an ex parte injunction limiting peaceful picketing, criminal charges against strikers were brought only in Maui County.

In Maui County, 125 strikers were charged with the following criminal offenses:

- 79 were charged with unlawful assembly and riot at Paia, Maui
- 22 were charged with riot, unlawful assembly, conspiracy and assault and battery at Lahaina, Maui
- 15 were charged with summary contempt of a restraining order limiting picketing to three
- 4 were charged with assault and battery
- 4 were charged with malicious injury
- 1 was ordered to show cause why he should not be put under a peace bond

All cases have been disposed of except the unlawful assembly charge against seventy-five strikers at Paia involved in this proceeding³⁹ and the contempt case which is pending before the Ninth Circuit Court of Appeals on appeal from the denial of a Writ of Prohibition by the Supreme Court of the Territory.⁴⁰

The unlawful assembly, riot and conspiracy charges against the twenty-two strikers at Lahaina, Maui, were nolle prossed. The remaining cases were disposed of without trial.

The only corporal injuries involved in the 125 Maui cases were assault and batteries on three white supervisors at Lahaina, Maui, as a result of which 22 strikers were charged.

That the attitude of the daily press in Hawaii towards unions, and particularly the union chosen by the plantation workers, has not changed substantially in recent years, is apparent from the photostatic copy of a cartoon published in the *Honolulu Advertiser*, successor of the *Pacific Commercial Advertiser*, during the 1946 Sugar Strike.

M. 1947 Pineapple Strike

In the first three days of the five-day pineapple strike, two hundred and fourteen arrests were made, and four anti-picketing injunctions issued. The union voted on the fourth day to return to work without achieving its demands.

Seventy-five of the arrests occurred on the Island of Lanai, Maui County. Seventy-three persons, including the individual plaintiffs,

³⁹ The 1946 indictment was declared defective by the Territorial Supreme Court in an interlocutory appeal, but the statute was held constitutional. The 1947 Maui Grand Jury reindicted for riot and added a new conspiracy count.

⁴⁰ *ILWU v. Wirtz*, 37 Haw. 404, #11,568, before the Ninth Circuit Court of Appeals.

were charged on police complaint with unlawful assembly and riot. After the strike was broken, charges against thirty-two strikers were dropped when the prosecution was unable to adduce evidence of these persons even being present at the time the alleged riot occurred.

On the Island of Oahu, there were one hundred and thirty-one arrests. One hundred were nolle prossed after the strike was over including one complaint charging violation of the anti-picketing law repealed in 1945; three were tried in the District Court and found not guilty; one was found guilty. One was acquitted after a jury trial. Charges of obstruction of the highway, profanity and disorderly conduct were disposed of on nolo pleas, and small fines were assessed.

Specific charges of police brutality were made by the union, and a public hearing before the Police Commissioner was demanded but refused.

On Kauai, twelve strikers were charged with obstructing the highway and malicious injury, one with criminal trespass (sitting under a palm tree on company property), and one with assault and battery. All charges except obstructing the highway were nolle prossed and on pleas on nolo contendere, fines were assessed.

III. LABOR INJUNCTIONS

In the 1946 sugar strike, two ex parte restraining orders drastically limiting peaceful picketing were issued. Two cases involving charges of contempt of these orders are now pending in the Ninth Circuit Court of Appeals.

In the Fishermen's Strike in 1947, an injunction was issued by Judge Cassidy of the First Circuit Court. The return showed that the strike had terminated, before the return day, and asked for the dissolution of the ex parte order on that ground. At the request of the attorney for Hawaiian Tuna Packers, and over the strenuous objections of attorneys for the union, the judge refused to dissolve the ex parte order and "suspended" its operation indefinitely.

In the 1947 pineapple strike, five injunctions drastically limiting peaceful picketing were issued by three circuit judges. Seven months after the voluntary dismissal of the equity suit, contempt proceedings were instituted by a special deputy attorney general against fourteen persons for alleged violations.

In July, 1948, at the instance of the Honolulu Rapid Transit Company, a circuit court judge restrained a strike on the ground the union had failed to comply with the Public Utilities Strike Act. The union contended that it had already gone through the cooling off period and mediation provided in the Act, but the company contended that since it had made additional demands, the procedures of the Act must be gone through again. The judge recognized in his decision that the attorney general was the proper plaintiff, but granted the injunction on the company's petition because of the interest of the public in continuing service. The hearing was held from two to five in the morning to prevent a stoppage of bus service since the members of the union insisted in appearing personally in response to the Summons issued against them.

IV. OTHER LAWS AND PRACTICES OF LAW ENFORCEMENT AGENCIES AFFECTING LABOR

The Territory has a so-called forty-eight hour law under which any person can be arrested and held for forty-eight hours on suspicion that a crime has been committed. Police officers do not advise persons arrested and held as to what are their rights not to testify against themselves, or warn them that statements they make will be used against them.

The result of the use and operation of the law is that the well-educated and well-to-do who know their rights are rarely held under the law, and it is generally invoked and useful against only the poor and those who do not know their rights.

The magistrates of the district courts do not apprise persons brought before them of their right to counsel, of their right to a jury trial, or of their right against self-incrimination, or in the case of district court complaints, in felony cases, of their right to a hearing.

Those who do not know their rights are thus deprived of them.

Bail is frequently set in labor cases higher than in ordinary criminal cases. Thus for example, twenty-five dollars is the usual bail fixed in misdemeanor cases. But in misdemeanor charges in labor cases, it is rarely set at less than fifty dollars to one hundred dollars.

Respectfully submitted,
HARRIET BOUSLOG

APPENDIX II

APPENDIX II.

MINORITY REPORT

ON

HOUSE BILL No. 442

**RELATING TO RIOTS AND THE DISPERSION THEREOF,
DEFINING OFFENSES AND PRESCRIBING PUNISHMENTS
THEREFOR, AMENDING THREE SECTIONS OF CHAPTER
277 OF REVISED LAWS OF HAWAII 1945, AND REPEALING
ALL OTHER SECTIONS OF SAID CHAPTER**

This bill in purport puts back into the laws of the Territory similar chapters to those recently declared unconstitutional by the three-judge Federal Court last year. The only outstanding difference is the reduction of the sentence of imprisonment from twenty to two years. And under the provisions of Section 7 more than 100 men can be prosecuted under the law then in effect with its maximum of 20 years.

Further it is a directive to the Attorney General to ignore several of the first ten amendments to the Constitution of the United States.

The three-judge Federal Court that declared the similar law unconstitutional made a comparison of it to the riot act of England in the year 1715 when a felony was punishable by death and stated, in effect, that laws similar to HB 442 were more severe than the riot act of England. The old territorial statute stated that **three men** for any length of time, note—any length of time if engaged in rioting violated the law whereas the old English law specified twelve or more and that the law was only effective if they engaged in rioting for an hour or longer.

Under the terms of section 11571 of HB 442 which makes it a riot if six or more disturb the peace or threaten so to do, in the case of a football game where the goal posts are torn down or a group of six or more threaten to do so the participants would be guilty of rioting and not only would the actual six be subject to the law

but any persons present could be arrested or imprisoned. In effect, everyone in the stadium who did not leave immediately when told to do so by an officer could be subjected to arrest and conviction under the provisions of Section 11581.

We cannot in the same breath say as Legislators that Hawaii is ready for Statehood and at the same time pass such unconstitutional legislation as is contained in House bill 442.

If we want to promote peace and harmony we should not pass laws that create bitterness, hate and animosity.

If we, as legislators, want to make Democracy work then we urge that every legislator of this House uphold his oath of office and vote against passage of House bill 442.

Respectfully submitted by the Minority,

EARL E. NIELSEN (s)

STEERE G. NODA (s)

APPENDIX III

APPENDIX III.

Here is the setting in which the statute was passed as described by W. A. Kinney in a book entitled, "Hawaii's Capacity for Self-Government All But Destroyed." Mr. Kinney, for sixty years a resident of Hawaii and a member of one of the largest law firms, Kinney, Ballou and Prosser, published the book in 1927 in Salt Lake City. The book was so critical of the sugar planters that it was almost completely suppressed, the copies being bought up from all bookstores by the targets of its attacks.

For five or six years prior to 1850, when the law was adopted, there was an increasing agitation among the growing number of planters to import coolie labor, finding the Hawaiians unwilling to work for the wages the planters were willing to pay.

Succeeding finally in getting the land divided among the people, and finally in making it alienable, more and more land came into the hands of the planters. But the planters were not satisfied with the native as a laborer. Finally the missionary advisers of the King persuaded him to approve a contract labor law with penal provisions for enforcement. (See Appendix I.) Mr. Kinney's judgment is not kindly:

Men with Bible in hand, and specific pledges to God of the most solemn and appealing kind, wound up by enslaving their own religious flocks, and getting their land away from them.

The unlawful assembly and riot statute was a necessary concomitant of the peonage law. Both were written by Chief Justice Lee, a eulogy of whom appears in the Record at page 1834.

Mr. Kinney thought somewhat less highly of Chief Justice Lee than appellants. Mr. Kinney could scarcely be described as pro-labor, for it was he who, when serving as special prosecutor for the H.S.P.A. during the 1909 Japanese strike, demanded of the Judge that the strikers not be permitted bail, arguing that it would be dangerous to allow them bail. (See Appendix I, p. 16.) He was also the special prosecutor in *Territory v. Soga*.

Of Chief Justice Lee, Mr. Kinney says at pages 91-92:

The address of Chief Justice Lee to the Hawaiian Agricultural Society, in 1850, on the occasion of being elected President of that Society, also illustrates the effrontery of the exploiting element. It should be borne in mind that when Chief Justice Lee, of the Hawaiian Judiciary, delivered this address, there were still in the Islands, according to a census just taken, 84,165 natives, against 1862 foreigners all told, and his exploiting audience was besprinkled with those who, at the time, were being aided in their support by church contributions from New England, as missionaries to the heathen. Judge Lee had the natives all but buried before he got through with his address, and had spade in hand to finish the job. Here it is, or a part of it:

"In a small island of the Pacific, which thirty years ago knew little culture, but that of the kalo patch, there has this day assembled the planter who counts his hundreds of acres of sugar cane and coffee trees, the farmer raising cargoes of vegetables for California, and the herdsman who gathers in his fold a thousand cattle. Indeed this is no every-day assemblage. I venture to predict that those who fill *our* places thirty years hence, will see *our* valleys blooming with coffee and fruit trees, *our* barren hillsides waving with luxuriant cane, and the grass huts now scattered over *our* lands, replaced by comfortable farm houses.

"There is one agent, however, that we require who holds the key of success — the great, brawny arm, hugefisted giant, called Labor. Now that the dark cloud is lifting from the natives (they were just emerging from an epidemic of measles and influenza) *there is hardly a nation left to save*. 'Alas, must this people perish—not by famine nor pestilence nor the sword, but by the *rust of Indolence, the canker of sloth*.' *Though but a lone remnant remain*, let us strive to gird it with strength to wrestle with its approaching destiny, to arm it with the healthy body, etc. Then if our last hope fails, etc., we can but commend it to Him in whose hands are the issues of life and death, etc."

At this time the Giant called "Labor" was being offered by the exploiters, and many of the native "Giants" were working for from 12½ to 25¢ per day, payable largely in goods on which Mr. Wyllie himself admitted a profit of one hundred per cent was not uncommon. These wages, Jarves the historian, computes was less than slave labor was costing the planters of the Southern States. That very year the peonage system had

been established in Hawaii; crops planted by the natives were being wasted by the cattle, and the lands of the King, chiefs and commoners were being swept away by foreigners in blocks, sometimes of thousands of acres. Under these conditions, the natives lived more upon their own holdings, or what was left of them, supplemented by much more lucrative employment, which, according to Jarves, they were very often able to obtain, and this they did in preference to accepting employment and small wages offered by aliens.

Nos. 12,300 and 12,301

IN THE

United States Court of Appeals
For the Ninth Circuit

WALTER D. ACKERMAN, JR., individually and as Attorney General of the Territory of Hawaii, and JEAN LANE, individually and as Chief of Police of the County of Maui,

Appellants,

No. 12,300

vs.

INTERNATIONAL LONGSHOREMEN'S & WAREHOUSEMEN'S UNION, a voluntary unincorporated association and labor union, et al.,

Appellees.

WALTER D. ACKERMAN, JR., individually and as Attorney General of the Territory of Hawaii, *Appellant,*

vs.

INTERNATIONAL LONGSHOREMEN'S & WAREHOUSEMEN'S UNION, a voluntary unincorporated association and labor union, et al.,

Appellees.

No. 12,301

Upon Appeal from the United States District Court
for the District of Hawaii.

APPELLANTS' REPLY BRIEF.

WALTER D. ACKERMAN, JR.,
Attorney General, Territory of Hawaii,

J. GARNER ANTHONY,
Special Deputy Attorney General,

RHODA V. LEWIS,
Assistant Attorney General,

RICHARD K. SHARPLESS,
Deputy Attorney General,

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CLERK

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Appellants,

vs.

No. 12,300

INTERNATIONAL LONGSHOREMEN'S & WAREHOUSEMEN'S UNION, a voluntary unincorporated association and labor union, et al.,

Appellees.

WALTER D. ACKERMAN, JR., individually and as Attorney General of the Territory of Hawaii, *Appellant,*

vs.

No. 12,301

INTERNATIONAL LONGSHOREMEN'S & WAREHOUSEMEN'S UNION, a voluntary unincorporated association and labor union, et al.,

Appellees.

Upon Appeal from the United States District Court
for the District of Hawaii.

APPELLANTS' REPLY BRIEF.

I. THE DECREES APPEALED FROM STAYED PENDING CRIMINAL PROSECUTIONS IN VIOLATION OF THE STATUTORY PROHIBITION.

The decrees below stayed four criminal proceedings then pending in the territorial courts¹ in violation of the act of Congress which commands that:

A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments. (Title 28, U.S.C. sec. 2283; formerly Judicial Code, sec. 265, 28 U.S.C. 379.)

- (1) **Section 2283 governs the relationship between the federal and territorial courts in Hawaii.**

The statutory prohibition is binding on the United States District Court for the District of Hawaii and the Court below so held. (R. 469.) Appellees do not deny that the statute has the same effect in Hawaii as elsewhere in the United States.

Section 86 of the Hawaiian Organic Act² is an adoptive statute of the type construed in *Balzac v. Porto Rico*,³ and section 2283 clearly is one of the statutes thereby adopted and made applicable to

¹Unless otherwise indicated record references are to No. 12300 in this Court or to the consolidated record Nos. 12300-12301. The Court below disposed of two cases in one opinion. (R. 370-520.) Separate decrees were entered on March 29, 1949, the decree in No. 12300 (R. 543-550) stayed Cr. Nos. 2412, 2413 and 2419, the decree in No. 12301 (12301, R. 89-96) stayed Cr. No. 2365.

²The amendments of Section 86 made upon the enactment of the Revised Title 28 were not substantial. They are reviewed in the appendix of the Opening Brief (p. 167).

³258 U.S. 298, 302. (Op. Br. pp. 167-168.)

Hawaii. As this Court held in *Alesna v. Rice*, 172 F. 2d 176, 179 (1949):

A result of Section 86(c) is that if a constitutional district court is precluded by statute or rule of law from interfering in state court proceedings similar to the proceedings in which this Rice order was issued, the United States District Court for the District of Hawaii is precluded from interfering with the territorial court proceedings. Section 86(d) has the same effect.

This court has recognized that the Organic Act places the courts of the Territory of Hawaii in a relatively similar position to the federal judicial system as are the state courts.

The purpose of Section 2283 is to preclude interference of United States District Courts in state court proceedings. It arose from the necessity of preventing friction between parallel systems of courts.⁴

Even without reference to the adoptive statute, the Supreme Court has construed the word "state" to include territories where, as here, such construction will carry out the policy of the statute.⁵

If the word "state" were an obstacle to the applicability of this statute in Hawaii then it would be equally so as to Title 28, Section 1343 (conferring jurisdiction on district courts in cases brought "to redress the deprivation, under color of any State law" of the civil rights of a citizen) and the cases would

⁴*Oklahoma Packing Co. v. Gas Co.*, 309 U.S. 4, 8-9 (1940); *Toucey v. New York Life Ins. Co.*, 314 U.S. 118, 129 (1941).

⁵*Waialua Co. v. Christian*, 305 U.S. 91, 109 (1938); *Stainback v. Mo Hock Ke Lok Po*, 336 U.S. 368, 383 (1949).

require reversal for lack of jurisdictional amount on the part of the individual appellees, the parties interested in the pending territorial criminal proceedings.

The Court below tied the applicability of Section 2283 in Hawaii to that of Section 2281, the three-judge court statute. (R. 468.) Likewise, the Court based its holding that Section 1343 applied upon the reasoning supporting the applicability of Section 2281. (R. 436.) Section 2281 (the three-judge court statute) was held inapplicable to the Territory of Hawaii in *Stainback v. Mo Hock Ke Lok Po* because of the long established rule of strict construction of that section, to avoid burdening the federal judicial system. The reasoning of the opinion signifies no rejection of the principles which call for applicability of Section 2283. On the contrary, the Supreme Court sustained the independence of the territorial courts, holding that "territorial like state courts, are the natural sources for the interpretation and application of the acts of their legislatures and equally of the propriety of interference by injunction" (336 U.S. 383). Professor Moore in his recent treatise on the judicial code, recognizes that although 2281 is not applicable to Hawaii, 2283 is.⁶

(2) Section 2283 is prohibitory.

The statutory command is that "a court of the United States may not grant an injunction to stay proceedings in a state court * * *". Appellees (Brief 38-9) attempt to support the position taken by the

⁶Moore's Judicial Code 407 (1949).

Court below (that despite the statute the Court in its discretion could enjoin the pending proceedings) by quoting a paragraph from a law review article⁷ which does not support them; the authors take the position that where a stay of pending state proceedings is sought in a Federal Court, the Court must make an inquiry on the merits to determine whether or not the case falls within an exception to the statute. *Smith v. Apple*, 264 U.S. 274 (1924), which is cited in the footnote to the passage quoted by appellees, holds that although the statute is not a jurisdictional statute it does prevent "granting relief by way of injunction in the cases included within its inhibitions" (264 U.S. 274 at 478).

In *Toucey v. New York Life Insurance Co.* (supra), decided several years after the cited article and cases, the Supreme Court stated that the statute was prohibitory, and since the enactment of Revised Title 28 has reiterated its prohibitory character "Title 28 U.S.C. No. 2283 forbids this exercise of power
* * * '8

The cases⁹ cited by the appellees and the Court below (Brief 17-18, 39-40, R. 471-475) as supporting the Court's discretion to ignore the command of the statute, deal with threatened future proceedings¹⁰ as

⁷Taylor & Willis, Federal Injunctive Power, 42 Yale L. J. 1169 (1933).

⁸*Callaway v. Benton*, 336 U.S. 132, 150 (1949).

⁹E.g. *Douglas v. Jeannette*, 319 U.S. 157 (1943), *Hague v. C.I.O.*, 307 U.S. 496 (1939), and *A.F.L. v. Watson*, 327 U.S. 582 (1946).

¹⁰In so far as the cases cited relate to criminal proceedings they are future threatened proceedings; even though in some of them arrests had occurred no injunctions were sought as to pending proceedings, see the cases in note 90 of the Opening Brief, pp. 184-187.

distinguished from pending proceedings, and hence are not in point. The statute applies to pending proceedings.¹¹ Pending proceedings cannot be enjoined even if further enforcement of the statute could be enjoined.¹²

(3) These cases do not come within any exception to the statute.

In *Toucey v. New York Life Insurance Co.* (supra), Justice Frankfurter undertook a comprehensive review of the exceptions to Section 2283. He listed five statutory "withdrawals" from the "sweeping prohibition" of the section (314 U.S. 118, 132-134). It will be noted that no mention is made of the Civil Rights Act (8 U.S.C. sec. 43; 28 U.S.C. sec. 1343) as being such an exception although the act antedated the case by some seventy years. Appellees cite no authority for such an exception, mistakenly relying on the cases of future threatened proceedings (Brief, p. 43). There is ample authority¹³ holding that the Civil Rights Act is not a statutory exception. Certainly the Civil Rights Act does not "expressly"^{13a} authorize an injunction to stay state court proceedings since it provides that jurisdiction "shall be exercised and enforced in conformity with the laws of the United

¹¹*Ex parte Young*, 209 U.S. 123, 161 (1908); 42 Yale L. J. 1169, 1191; 43 Harv. L. Rev. 345, 375.

¹²*Cline v. Frink Dairy Co.*, 274 U.S. 445, 452-453 (1927); *Ex parte Young*, supra; *Camden Interstate Ry. v. City of Catlettsburg*, 129 Fed. 421 (1904); *St. Louis & S. F. R. R. v. Allen*, 181 Fed. 710, 722 (1910); Op. Br. pp. 84, 86.

¹³See cases collected in our Opening Brief, pp. 88-90, but see contra *Cooper v. Hutchinson* (C.A. 3d), 19 L.W. 2050, decided July 21, 1950.

^{13a}See Section 2283.

States''.^{13b} Moreover, the Supreme Court has interpreted the Civil Rights Act as not allowing a suit in equity if, under preexisting standards, it was not a proper proceeding.^{13c} And since the denial of any constitutional right comes within the scope of the Civil Rights Act, the Supreme Court's holding that the statutory prohibition is not lifted by an attack on the constitutionality of a state statute^{13d} or by other alleged denials of constitutional rights^{13e} is decisive.

As to the so-called judicial exceptions to the act, Justice Frankfurter in the *Toucey* case stated:

We find therefore that apart from congressional authorization only one exception has been imbedded in section 265 by judicial construction, to wit the *res* cases. The fact that one exception has found its way into section 265 is no justification for making another. (314 U.S. 118, 139.)

When the present Section 2283 was enacted certain changes in wording were made, the effect and

^{13b}R.S. 722, now 8 U.S.C. 49a (contained in March 1949 supplement), formerly 28 U.S.C. 729. This section requires conformity to federal law when there is a federal rule governing the case, and allows resort to the common law only when there is no such federal rule. *United States v. Thompson*, 251 U.S. 407, 416 (1920). Moreover, the common law rule, as shown in Point II, *infra*, does not allow equitable intervention in pending criminal proceedings.

^{13c}*Giles v. Harris*, 189 U.S. 475, 486 (1903).

^{13d}See cases cited in note 12 and *Monamotor Oil Co. v. Johnson*, 292 U.S. 86, 97 (1934).

^{13e}*Essanay Film Co. v. Kane*, 258 U.S. 358, 361 (1922), where the Supreme Court said, referring to the section of the judicial code which is now Section 2283:

That appellant's objection to the action sought to be restrained rests upon a fundamental ground and one based upon a provision of the Constitution of the United States, does not render the effort to stay proceedings in the state court any the less inconsistent with § 265, Judicial Code. * * *

intention of which are set forth in the Reviser's Notes.¹⁴ The only change in substance^{14a} was to restore statutorily the relitigation exception struck down by the *Toucey* decision (*supra*).

The Court below considered material, in deciding whether it would exercise discretion to depart from the statute, the impact of the criminal statute on labor relations, the motives of the prosecution, and the Civil Rights Act. (R. 480, 483.) But as we have shown the Court possesses no discretion to depart from the statute save for cases falling within the *res*, relitigation and statutory exceptions. The *res* and relitigation exceptions are not involved, and the Civil Rights Act is not one of the statutory exceptions. Neither the motives of the prosecution nor the impact of the statute on labor relations is material in any event.^{14b} Hence there is no exception to the statute preventing its application to these cases.

¹⁴U.S. Code Cong. Service, Title 28, sec. 2283, Reviser's Notes p. 1910.

^{14a}See Opening Brief, p. 87, note 67.

^{14b}See Opening Brief, pp. 97-99, 103-133; there is no exception to the statute in cases involving motive or labor controversies. Moreover, on these matters the District Court committed flagrant error in its findings. This was the result of a gross distortion of the doctrine of judicial notice. The Court took "judicial notice" of highly controversial facts not presented except in the unsworn memorandum of counsel. Appellees realizing the insufficiency of the record have again in this Court attached to their brief the same memorandum, which they offer as a substitute for proof. Judicial notice, of course, cannot be used as a substitute for evidence on controversial issues of fact, Morgan, Judicial Notice, 57 Harv. L. Rev. 269 (1944).

(4) The decrees below violated Section 2283.

In *Hill v. Martin*, the Supreme Court said:

The prohibition of section 265 (now 2283) is against a stay of 'proceedings in any court of a state'. That term is comprehensive. It includes all steps taken or which may be taken in the state court or by its officers from the institution to the close of final process.¹⁵

The Supreme Court cited *Hyattsville Building Assn. v. Bouic*,¹⁶ and *United States v. Collins*,¹⁷ which was applied in *Yick Wo v. Crowley*,¹⁸ a case holding that the statute prohibited a Federal Court from restraining the service of a state Court warrant of arrest.

The four criminal proceedings enjoined by the decree below were commenced by the issuance of warrants on police complaints following which the defendants were preliminarily arraigned before a district magistrate and committed to the circuit court of the County of Maui for further action in accordance with the appropriate statutes. (R. 88-93, 93-99, 138-323, 1282-1283.) This procedure is authorized by statute, Section 10770, Revised Laws of Hawaii 1945, and is often used as an alternative to the issuance of a bench warrant after indictment.¹⁹ A proceeding so

¹⁵296 U.S. 393, 403 (1935).

¹⁶44 App.D.C. 408 (1916).

¹⁷Fed. Cas. 14834 (1858).

¹⁸26 Fed. 207 (1886).

¹⁹*United States v. Simon*, 248 Fed. 980 (1916); *Garrison v. Johnston*, 104 F.2d 128 (C.A. 9th, 1939).

commenced is pending although no indictment has been returned.²⁰

In No. 12300 filed December 1, 1947, the decree enjoins "the prosecution commenced July 16, 1947 (R. 548)", "the prosecution commenced July 15, 1947 (R. 549)", and "the prosecution commenced August 1, 1947 (R. 549)"; in No. 12301 filed December 31, 1947, the decree enjoins "the prosecution commenced in October 1946" (No. 12301, R. 95). These injunctions clearly violate Section 2283 and must be reversed.

(5) The statute cannot be circumvented by calling the relief "declaratory".

Appellees, to escape the force of the statute, make the argument (Brief, pp. 23, 74) that the relief sought by them as to the grand jury "is declaratory and not injunctive." It is well settled that the declaratory judgment act cannot "be used to give relief indirectly which could not be given directly".²¹ This was established in *Great Lakes Co. v. Huffman*,²² which involved a statute analogous to Section 2283, forbidding federal court interference with state procedures for collecting taxes and limiting attacks on a state tax act to the recovery of the tax after it has been paid. The Court held that the policy underlying the statute required a like restraint in the use of the declaratory judgment procedure and made it the duty of the Court

²⁰*Southern Surety Co. v. Oklahoma*, 241 U.S. 582, 587 (1916).

²¹*Clark v. Memolo*, 174 F.2d 978, 980 (App. D.C. 1949).

²²319 U.S. 293 (1943).

to withhold this type of relief. (319 U.S. at pp. 299, 301.)

Even as to federal criminal proceedings an action for declaratory relief cannot be used as a substitute for the traditional means of determining the constitutional issues in the criminal cases, i.e. by a motion in the criminal court or petition for habeas corpus.²³ Clearly if the declaratory judgment procedure could be used to litigate each constitutional issue in a criminal case the case would be subject to innumerable interruptions and the criminal courts could not function.

II. THE DECREES BELOW VIOLATE THE SETTLED PRINCIPLE THAT EQUITY WILL NOT INTERFERE WITH PENDING CRIMINAL PROCEEDINGS.

The policy behind Section 2283 (that of preventing friction between the parallel state and federal systems of courts) applies to all proceedings criminal and civil. But where the proceeding sought to be enjoined is criminal, the further rule that "courts of equity * * * will not interfere to stay proceedings in any criminal matters, or in any cases not strictly of a civil nature"²⁴ applies. This principle of equity jurisprudence has not been changed by the Civil Rights Act which "does not extend the sphere of

²³*Clark v. Memolo*, supra; *Valenti v. Clark*, 83 F.Supp. 167 (D.D.C. 1949); *Brown v. Royall*, 81 F.Supp. 767 (D.D.C. 1949), cert. denied 339 U.S. 952.

²⁴2 Story's Equity Jurisprudence, 10th Ed., 1873, sec. 893; *In re Sawyer*, 124 U.S. 200, 210 (1888); *Harkrader v. Wadley*, 172 U.S. 148, 170 (1898).

equitable jurisdiction in respect of what shall be held an appropriate subject matter for that kind of relief".²⁵ Lacking jurisdiction to intervene in pending criminal proceedings, an equity court's exercise of discretion is confined to future threatened proceedings. In *Babcock v. Noh*, 99 F. 2d 738 (C.A. 9th 1938), a district Court had restrained the prosecuting attorney of Twin Falls County, Idaho, from proceeding with the pending prosecution of the plaintiff. In reversing the decree this Court said:

In support of the decree appellee argues broadly that a court of equity may enjoin a criminal prosecution under a void statute where such prosecution amounts to a wrongful invasion of a property right (citing cases). However, the present suit is not within the principle announced in these authorities. What was sought in those cases was relief against threatened, not pending, prosecutions; and in them the court proceeded upon the view that one is not compelled to test the constitutionality of an act by first incurring drastic penalties attached to its violation, but may, under extraordinary circumstances, appeal to equity for relief against the invasion of his property rights through the threatened enforcement of the statute. * * * Here, no threat of the institution of other criminal proceedings under the act is alleged in the bill or found to have been made. The relief sought is against the further prosecution of the pending case. * * *

The constitutional question said to be for determination by the Federal court is one which

²⁵*Giles v. Harris*, 189 U.S. 475, 486 (1903).

the state court is competent to deal with in the criminal action pending before it. Its decision of the federal question is subject to ultimate review in the Supreme Court of the United States. There is plainly no warrant for equitable interference with the proceedings in the state tribunal, even in the absence of the prohibition against such interference contained in section 265 of the Judicial Code, 28 U.S.C.A. section 379. (99 F. 2d pp. 739-740.)

While equity will not interfere in criminal proceedings, such proceedings are subject to attack by a writ of habeas corpus. However, under the exhaustion of remedies rule the Supreme Court has rounded out the policy of section 2283²⁶ by limiting federal habeas corpus interference with state criminal cases. The rule requires that all issues in state criminal cases first be presented in the state courts, then appealed all the way through the proper appellate courts and certiorari asked in the United States Supreme Court before a writ of habeas corpus will be entertained in a federal district court.²⁷ The rule is binding on the lower courts, subject to only a few exceptions for cases involving the operations of the federal government, the authority of its officers, and foreign relations. (Op. Br. pp. 91-92, 105-106.) The Supreme Court is unwilling to create further exceptions. *Dye v. Johnson*, 338 U.S. 864 (1949), reversing *Johnson v. Dye*, 175 F. 2d 250 (1949).

²⁶*Darr v. Burford*, 339 U.S. 200, 204 (1950), footnote 10.

²⁷*Darr v. Burford*, *supra*.

By reason of section 2283, the lack of equity jurisdiction over criminal proceedings, and the exhaustion of remedies rule, the protection of state criminal courts against federal court interference is complete. The decrees below were issued in violation of the established rule of non-interference and should therefore be reversed.

III. THESE CASES INVOLVE NO FUTURE PROSECUTIONS.

As these cases stand today they involve no possibility of future prosecutions, the statutes having been amended. (Op. Br. p. 92.) But even in the Court below it was true that no future prosecutions were involved. (Op. Br. pp. 92-99.) The Court issued no injunctions against future prosecutions. (R. 12300, pp. 543-550; R. 12301, pp. 89-96.)

No further prosecutions could be involved unless they were threatened;²⁸ the complaints below did not allege such threats,²⁹ and no evidence of such threats was introduced. (R. 12300, pp. 2-21, 33; 12301, pp. 2-26.)

For the cases to involve threats of further prosecutions, moreover, the threats would have to be directed

²⁸*Watson v. Buck*, 313 U.S. 387, 400 (1941), injunction proceedings; *Southern Pacific Co. v. Conway*, 115 F.2d 746 (C.A. 9th 1940), declaratory judgment proceedings; *Hoffman v. O'Brien*, 88 F.Supp. 490, 493, aff'd 339 U.S. (May 15, 1950), declaratory judgment and injunction proceedings.

²⁹Compare the allegations with those in *Hoffman v. O'Brien*, *supra*.

against the union's peaceful picketing activities. Mere allegations of unconstitutionality of a statute are not enough; the threatened interference must impinge upon the enjoyment of some property right or personal right.³⁰ Of course the right asserted must be one recognized as entitled to protection.³¹ And since the jurisdiction of the District Court is founded upon the Civil Rights Act,³² such right must by the terms of the statute be one protected by the Constitution or laws of the United States.

The acts for which the union claimed protection were "certain lawful, peaceful and constitutionally protected activities of speech, press and assemblage and of peaceful picketing" (R. 12300, p. 9; 12301, p. 13). But there was no proof of interference, actual or threatened, with such activity. No showing was made that the statutes were being so used as to prevent resort by labor to any recognized legitimate weapons in its armory.

³⁰*Hynes v. Grimes Packing Co.*, 337 U.S. 86, 99 (1949), injunction proceedings; *National Maritime Union v. Herzog*, 78 F.Supp. 146, 154, aff'd 334 U.S. 854 (1948), injunction proceedings; *United Public Workers v. Mitchell*, 330 U.S. 75, 89-91 (1947), declaratory judgment and injunction proceedings; *Ashwander v. Tennessee Valley Authority*, 297 U.S. 288, 324 (1936), declaratory judgment and injunction proceedings; 28 Am.Jur. Injunctions 369, sec. 182.

³¹Cf. *Earle C. Anthony Inc. v. Morrison*, 83 F.Supp. 494 (1948), aff'd 173 F.2d 897 (C.A. 9th, 1949), cert. denied 338 U.S. 819 (1949); *Drummond v. Rowe*, 155 Va. 725, 156 S.E. 442 (1931); 39 Ill. L. Rev. 144, 146; 51 Harv. L. Rev. 623; 175 A.L.R. 438, 447.

³²Section 1343 of Revised Title 28 (formerly section 24(14) of the Judicial Code, 28 U.S.C. 41(14)). The same is true if jurisdiction is founded on section 1331 of Revised Title 28 (formerly section 24(1) of the Judicial Code, 28 U.S.C. 41(1)), or on section 1347 (formerly section 24(8) of the Judicial Code, 28 U.S.C. 41(8)).

The findings of the Court below (R. 391-395, 402-405, 408), as to the acts out of which the four criminal proceedings arose, refute completely any claim that they were the kind of activity for which protection was claimed in the complaint. The conduct of appellees, to summarize the Court's detailed description of the events, can best be characterized as consisting of mass force, threats of violence, and violence. Thus, nothing in these cases afforded any basis for the inference that the union would in the future be interfered with in its exercise of peaceful picketing.

Appellees' assertion that "a person has the right not to be arrested and prosecuted under laws that abridge freedom of speech", even if he has committed an assault (Ans. Br. p. 29) does not take into account the question of where the right is asserted. This was the error that the trial Court fell into (R. 485). Of course, a person guilty of acts of violence can, in the criminal proceedings, both at the trial and on appeal, assert the invalidity of the statute as a defense,³³ but equity will grant him no protection in perpetrating further acts of violence.³⁴

³³Appellees' hypothetical case does not disclose how good the defense would be. Even if a statute, in some aspects, abridges freedom of speech, there still remains the possibility that it can be constitutionally applied in the particular criminal proceeding involved. See *Dorchy v. Kansas*, 272 U.S. 306, 309 (1926); *Stromberg v. California*, 283 U.S. 359, 367-368 (1931); *Thomas v. Collins*, 323 U.S. 516, 541 (1945); *Terminiello v. Chicago*, 337 U.S. 1, 5 (1949); see also *Thornhill v. Alabama*, 310 U.S. 88, 96 (1940); *Chaplinsky v. New Hampshire*, 315 U.S. 568, 572-573 (1942).

³⁴In view of the fact that in the opinion of the Court below the question here discussed (whether the union had shown threatened interference with the kind of activity, i.e. peaceful picketing, for

The requirement of a showing of threatened interference with property rights or activities claimed to be constitutionally or legally protected is separate and apart from the requirement, standard in all equity cases, of a showing of irreparable injury and the additional requirement in cases to enjoin enforcement of state statutes of a showing of exceptional circumstances. The first requirement naturally must be met before the Court is called on to consider the other two requirements. In *A.F.L. v. Watson*, supra, the activity claimed to be protected by the Constitution and laws of the United States was the making of closed shop contracts.³⁵ In *Douglas v. Jeannette*, supra, it was the distribution of religious literature. In our case, however, the right asserted, to come within the scope of the interference shown, would have to be a right to use mass force and violence, which obviously is not a right. On the other hand, the statutes had not been invoked against peaceful picketing, hence it could not be inferred that interference with that activity was threatened. The requirement of a threat to interfere with constitutionally protected rights has not been met and the Court below erred in entertaining these cases.

which protection was sought in its complaint) appears under the heading "the defense of unclean hands" (R. 485), it is relevant to note that appellants had moved to dismiss on the ground the union was not so threatened (No. 12300, p. 125; No. 12301, p. 62; motion renewed R. 1570), as well as on the ground of unclean hands. As to the latter ground, see Op. Br. pp. 100-103.

³⁵The district court was ordered to stay proceedings to await state court determination of the questions of local law. Ultimately the making of closed shop contracts was held not protected by the laws of the United States. *Algoma Plywood v. Wisconsin Board*, 336 U.S. 301 (1949).

IV. THE COURT ERRED IN INVALIDATING THE STATUTES AND THE GRAND JURY.

A.

THE UNLAWFUL ASSEMBLY AND RIOT STATUTE.

- (1) The court below had no authority to reconstrue the unlawful assembly and riot statute.

The rule is that the interpretation of a state statute is a matter of local law, and that the federal question begins only with the statute as authoritatively interpreted by the local Court. Had the Court below abided by this rule, and accepted the Supreme Court of Hawaii's construction of the statute, it could not have reached the result it did on the constitutional issues.

Appellees nullify this rule when they state: "Federal courts are not bound by the construction placed on a statute where the question is a question of conflict with the federal constitution" (Brief, p. 67). This is the exact opposite of the correct rule.³⁶

Appellees also assert that the interpretation placed on the statute by the Supreme Court of Hawaii was "manifestly erroneous" (Brief, p. 68). They fail to recognize that the appellate jurisdiction enjoyed by this Court in cases of clear or manifest error in matters of local law, such as interpretation of a territorial statute, does not pertain to the Federal District Court.³⁷

³⁶*A.F.L. v. Watson*, 327 U.S. 582, 598, *Musser v. Utah*, 333 U.S. 95, 98 (1948), and other cases cited in our Opening Brief, pages 54-56; see also the recent case of *Shipman v. Dupre*, 339 U.S. 321 (1950).

³⁷See our Opening Brief, note 27, pages 172-173.

As to the parties in the *Kaholokula* case, more than the interpretation of the territorial statute is involved. The Supreme Court of Hawaii's upholding of the constitutionality of the statute established the law of the case which the Circuit Court must follow. To be sure, this Court might reverse the Supreme Court of Hawaii but the United States District Court may not.³⁸ Nor should the "congressional policy against piecemeal appeals in criminal cases" be thwarted.³⁹

(2) Appellees' argument that: "The act is unconstitutional on its face."

Appellees draw a distinction between the statute "on its face" and as interpreted by the Supreme Court of Hawaii (Brief, pp. 59 and 65). There is no such distinction to be made. As shown by *Toomer v. Witsell*,⁴⁰ a Federal District Court having before it a statute which has not been construed by the State Court has to decide whether the statute requires interpretation by the State Court before the Federal District Court can pass on the constitutional issue; the considerations which influence its determination are set forth in *Railroad Commission v. Pullman Co.*,⁴¹ and *A.F.L. v. Watson*.⁴² Here no such problem was presented; the statute had been construed. The question was whether the statute as so construed was con-

³⁸*Borland v. Johnson*, 88 F.2d 376 (C.A. 9th, 1937), cert. denied 302 U.S. 704, and other cases cited in our Opening Brief, pages 53-54.

³⁹*Roche v. Evaporated Milk Assn.*, 319 U.S. 21, 30.

⁴⁰334 U.S. 385, 392, note 15, cited Brief, page 59.

⁴¹312 U.S. 496, 499-500 (1941).

⁴²327 U.S. 582, 595-599 (1946).

stitutional. When *Chaplinsky v. New Hampshire*,⁴³ in which the opinion was written by Mr. Justice Murphy, is contrasted with *Thornhill v. Alabama*,⁴⁴ it appears that the *Thornhill* case does not hold State Court construction may be ignored. The case is one of a group holding that where a person has been convicted upon a record which demonstrates a too broad construction of the statute, so that his punishment may be attributable to acts which under the Constitution cannot be punished, the presence in the record of evidence of unlawful acts which under the Constitution may be punished will not save the judgment.⁴⁵

Appellees argue that the unlawful assembly and riot statute is "flagrantly and patently violative of express constitutional prohibitions in every clause, sentence and paragraph, and in whatever manner and against whomever an effort might be made to apply it", quoting from *Watson v. Buck*, 313 U.S. 387 (1941), where it is said to be conceivable that there might be such a statute (Brief, p. 59). Appellees make no endeavor to support this argument by reference to the various provisions of the statute. Appellees' argument (Brief, p. 64, where Professor Chaffee's book is misconstrued) in substance is that the crime of riot cannot exist under the Constitution of the United States, because the existence of an assembly is a constituent element of the offense of riot.

⁴³315 U.S. 568, 572-573 (1942).

⁴⁴310 U.S. 88 (1940), cited by appellees. (Brief, p. 59.) The *Thornhill* case is the only one of the four cases cited by appellees in which the statute had been construed.

⁴⁵Accord see: *Thomas v. Collins*, 323 U.S. 516, 541 (1945); *Stromberg v. California*, 283 U.S. 359, 367 (1931).

This argument is disposed of in *Cole v. Arkansas*,⁴⁶ which holds that the existence of an assembly may be an element of a criminal offense where the offense is confined to an assembly having an unlawful purpose and to persons who join in the promotion of that purpose. The relevant questions therefore have been met in the opening brief⁴⁷ where it is shown that: (1) Acts which create a clear and present danger of breach of the peace may be made unlawful, under the Constitution. (2) The Hawaii statute requires as an element of the offense “acts which strike or tend to strike terror into others”, and therefore is confined to cases of clear and present danger of breach of the peace. (3) The statute prescribes a test of accountability which protects a person who does not join in the promotion of the unlawful acts; the statute is of the type sustained in *Cole v. Arkansas*, *supra*. Thus under the statute the accountability of each person is a question of fact, as held in *Whitney v. California*,⁴⁸ where the Supreme Court said the existence of such a question of fact presents no constitutional question.

(3) Asserted resemblance to statute of George I.

Appellees argue that the Hawaii statute is not the kind of statute above outlined, that it is the counterpart of the statute of George I (Brief, pp. 59-63). That statute, which made it an offense to fail to disperse upon an order to do so, is attacked by appellees

⁴⁶338 U.S. 345 (1949), Op. Br. pp. 66-69.

⁴⁷Op. Br. pp. 62-70.

⁴⁸274 U.S. 357, 366-369 (1927), Op. Br. p. 69.

on the theory (Brief, p. 62) that the conferring of authority to order a dispersal is an interference with the right of assembly. There were two separate offenses in England, the distinguishing characteristics of which were that the common law offense made one accountable for the acts constituting the riot and had nothing to do with an order of dispersal, while the statutory offense made one accountable for his failure to disperse upon an order to do so.⁴⁹ In many of the states of the United States, as in Hawaii, these two separate offenses are contained in the statutes.⁵⁰ Sections 11570-11575 of the Hawaii statute,⁵¹ as held by the Supreme Court of Hawaii, were based on the common law, not the statutory offense of failure to disperse. The dispersal provisions contained in sections 11576-11577 and 11581-11584 are not involved.

No order of dispersal appears in these cases; the giving of such an order was not averred in the criminal charges and the facts show none.⁵² Therefore there is no need to complicate the issues by considering whether the dispersal provisions of the Hawaii statute (sections 11576-11577 and 11581-11584) are of the same type as those in the statute of George I. That they are not was shown in the opening brief.⁵³

⁴⁹Authorities explaining the common law offense and the statute of George I are cited in our Opening Brief, pages 57-59.

⁵⁰See our Opening Brief, page 59, notes 32-34.

⁵¹The Hawaii statute is printed in the appendix of our Opening Brief, pages 188-192.

⁵²See the resumé of the criminal charges in our Opening Brief, page 60, note 35.

⁵³Op. Br. note 22b, pp. 170-172.

The dispersal provisions of the Hawaii statute are separable from the sections codifying the common law offense; this appears from the *Kaholokula* case in which the Supreme Court of Hawaii laid them aside as not involved. Severability is a question of local law.⁵⁴ Moreover, *United States v. Reese*, cited by appellees,⁵⁵ contains no holding that a penal statute prescribing several different ways in which a crime can be committed must stand or fall as a whole. To the contrary, the case recognizes that words may be struck out and that one part of the statute may be separated from the remainder, holding only that no such case is presented where, to effect the separation, it would be necessary to introduce words into the statute.

The Court below accepted the Supreme Court of Hawaii's holding that an order of dispersal was not an element of the offense involved (R. 450-451), but seems not to have understood that this necessarily stamped such offense as derived from the common law, not the statutory offense. The Court below ignored the existence of the common law offense (R. 444-452). This led the Court into further errors, in that, as shown below, the Court failed to interpret the terms of the statute in the light of the common law.

⁵⁴Severability is a statutory construction question, hence a question of state law. *Rescue Army v. Municipal Court*, 331 U.S. 549, 573-574 (1947), and other cases cited in our Opening Brief, page 60.

⁵⁵92 U.S. 214, 222 (1875), cited Brief, p. 66.

(4) Appellees' argument that the statute provides no ascertainable standard of conduct.

Appellees and the Court below (Brief, p. 64, R. 454) cite *Lanzetta v. New Jersey*⁵⁶ and *United States v. Cohen Grocery Co.*⁵⁷ for the proposition that the statute affords no ascertainable standard of conduct. In the *Lanzetta* case the Court pointed out that the meaning of the statute was not derivable from the common law (306 U.S. at p. 455). This also was true of the *Cohen Grocery Co.* case. In the Hawaii statute common law terms are employed; therefore the requirements of certainty are met.⁵⁸ Only by departure from this well established principle could the lower Court hold that the test laid down by the words "striking terror or tending to strike terror into others"⁵⁹ was "purely subjective", lacking "the test of reasonableness". (R. 453.)

B.

THE CONSPIRACY STATUTE.

Appellants' opening brief showed that the first portion of the conspiracy statute under which the offense of conspiracy is committed by a mutual undertaking "to commit any offense or instigate anyone thereto" is complete in itself and constitutional, that the lower Court made no objection to this first portion of the

⁵⁶306 U.S. 451 (1939).

⁵⁷255 U.S. 81 (1921).

⁵⁸*Nash v. United States*, 229 U.S. 373, 376 (1913), as construed in *Connally v. General Construction Co.*, 269 U.S. 385, 391 (1926), and other cases cited in our Opening Brief, page 62.

⁵⁹That these words have a well settled meaning at common law, encompassing the reasonable man test, was shown in our Opening Brief, pages 62-64.

statute, that this portion of the statute is involved in No. 12301 (the only case having to do with the conspiracy statute) and that the statute could not be struck down as a whole.⁶⁰

Appellees, like the Court below, make no attempt to show the unconstitutionality of this first portion of the statute. They argue (Brief, p. 69) that the assaults and batteries which were the objects of the alleged conspiracy, were not fully carried out, which of course is not relevant to the offense of conspiracy.⁶¹ The only other argument made is under the *Reese* case (Brief, p. 73) which as previously pointed out recognizes the rule that a penal statute separately setting out different ways in which an offense can be committed is severable. Appellees remark on the absence of a severability clause (Brief, p. 73). But the Hawaii Courts do not require a severability clause, and as above noted severability is a question of local law. The first and second portions of the statute clearly were severable.⁶²

That the Court erred in invalidating the entire conspiracy statute can admit of no doubt. Criminal No. 2365 should have been allowed to proceed; if a conviction resulted the appellate court would consider whether it was based on an invalid portion of the statute.⁶³

⁶⁰Op. Br. pp. 72-74.

⁶¹11 Am.Jur. 546, sec. 6.

⁶²*Territory v. Tam*, 36 Haw. 32, 51 (1942), relating to a statute in which there was no severability clause, and cases there cited.

⁶³*Territory v. Tam*, supra; *Ex parte Bell*, 19 Cal.2d 488, 122 P.2d 22 (1942); *Stromberg v. California*, 283 U.S. 359, 367-368 (1931).

As to the second portion of the statute, the Hawaii cases decided under it have been cases of conspiracies having fraudulent or unlawful objectives or fraudulent or unlawful means.⁶⁴ Appellees' attack on the *Soga* case (Brief, pp. 69-70) concerns the sufficiency of the evidence to sustain the verdict; the means charged in that case were threats of violence. Unlawful means were charged in Criminal No. 2365, the case here involved (No. 12301, R. 32-34). An unconstitutional construction of the statute could not be assumed any more than in *Musser v. Utah*⁶⁵ or *United States v. Petrillo*.⁶⁶

C.

THE QUESTION OF DENIAL OF EQUAL PROTECTION.

The Court below did not find any denial of equal protection. It could not, because the basic elements of a claim of denial of equal protection were not proven.⁶⁷

Appellees do not deny that the basic elements of a claim of denial of equal protection are as set forth in the opening brief, nor could they deny it in view of their own pleadings. (R. 13, subpar. (6); No. 12301,

⁶⁴*King v. Anderson and Russell*, 1 Haw. 67 (1851); *King v. Marks*, 1 Haw. 81 (1851); *Territory v. Johnson*, 16 Haw. 743 (1905); *Territory v. Soga*, 20 Haw. 71 (1910); *Territory v. Beliveau*, 23 Haw. 546 (1916), and 24 Haw. 768 (1919); *Territory v. Hart*, 35 Haw. 188 (1939).

⁶⁵333 U.S. 95, 97 (1948).

⁶⁶332 U.S. 1, 11 (1947).

⁶⁷The basic elements of a claim of denial of equal protection are set forth in our Opening Brief, pp. 76-78, and the facts are there reviewed, pp. 78-82.

R. 15.) Appellees make no attempt to show that they met the requirements of proof.

D.

THE 1947 GRAND JURY.

In No. 12300, the grand jury issue is moot (Op. Br. pp. 134-135). Appellees in effect concede this (see last paragraph of Brief, p. 83). In No. 12301 the court below erred in deciding that it could and should pass upon this issue, not only for the reasons set forth in points I and II but also for the reason that a grand jury challenge cannot be initiated collaterally (Op. Br. pp. 137-143).

The Court's conclusion in No. 12301 that the 1947 grand jury list was comprised illegally was based on its findings (R. 505, 509) below considered. The territorial statutes⁶⁸ were not under attack and were valid, as shown in the opening brief.⁶⁹ The statutes provide for selection of a grand jury list of fifty according to the best judgment of the commissioners, not by lot from all eligibles.

The plan followed by the jury commissioners was one of geographical representation. Unlike the jury commissioners in *Smith v. Texas*,⁷⁰ they had a wide acquaintanceship with the people of Maui County, a small rural community. This acquaintanceship extended to persons of many races and in many walks

⁶⁸The statutes are printed in the appendix of the Opening Brief, pp. 213-222.

⁶⁹Op. Br. p. 157.

⁷⁰311 U.S. 128 (1940). (Brief, p. 83.)

of life, as shown by the very testimony cited by appellees.⁷¹ The jury commissioners were able to carry out their plan of geographical representation through this wide acquaintanceship and by sending out questionnaires. (R. 703-705, 711-713, 804-805, 832, 888). Appellees have not shown that a plan of geographical representation is forbidden.

(1) The alleged deliberate exclusion of Filipinos.

Appellees rely upon certain cases arising in the southern states, in which a *prima facie* case of discrimination against negroes was presented by means of population statistics, coupled with proof of absence of negroes from juries over a long period of years. (Ans. Br. p. 76.) These cases concerned a citizen group long a part of the community.⁷² The eligible Filipino group in Maui County is both recent and minute. For this and other reasons shown in our opening brief, the southern state cases do not apply.⁷³

The Court below did not base its opinion on the population statistics. (R. 502-504.) Its conclusion that Filipinos had been deliberately excluded was based solely on nine words from the testimony of Jury Commissioner Augustine Pombo. (R. 504.) These words were removed by the Court from their context, and their meaning thereby changed. From the full testimony on the matter,⁷⁴ it appears that Mr. Pombo

⁷¹Brief, p. 83, third paragraph, which evidently refers to R. 806-808, 831-840, 889-914, 715-723, 737-753.

⁷²Cf. *Moore v. New York*, 333 U.S. 565, 568 (1948).

⁷³Op. Br. pp. 146-147, 152-154.

⁷⁴Op. Br. pp. 150-151, note 138, covering R. 848-850.

testified he picked a man on his merits. The other jury commissioners also testified that no one was rejected by reason of race. (R. 791, 914.) That the jury commissioners had no plan of excluding Filipinos appears from the fact that, in processing the returned questionnaires, they classified at least four Filipinos as qualified. (R. 857, 1514.)

(2) The alleged deliberate weighting of the list in favor of haoles and against wage earners.

Appellees endeavor to present the matter of representation of haoles as a racial issue. (Brief, pp. 78-79.) The Court below deemed this matter incidental to the occupational representation issue. (R. 509.) It will be so treated in this brief.

Appellees attempt to set up a rule of proportionate occupational representation. However, their computations are valueless.⁷⁵ Moreover, the proposition is the same one rejected by this Court in *Thiel v. Southern Pacific Co.*⁷⁶ and *Local 36 of Internat'l Fishermen v. United States*,⁷⁷ rejected by the United States District Court for the northern district of California

⁷⁵See Appellees' Brief, pp. 81-82. Appellees have not eliminated non-citizens from the population before computing population percentages; in view of the large number of non-citizen laborers this error is substantial. Their figures deviate from the record; a witness would have to be put on the stand to explain how the figures were 'adapted from Table 3'. (Brief, p. 81, note 14.) Appellees shift their attack (Brief, p. 88) from the list of fifty to the grand jury panel or array, drawn by lot (R. 1801) from the list of fifty; the record presents no attack upon the panel or array.

⁷⁶169 F.2d 30 (1948), cert. denied 335 U.S. 872, affirming 67 F. Supp. 934 (1946).

⁷⁷177 F.2d 320 (1949), cert. denied 339 U.S. 947, affirming 70 F. Supp. 782 (1947), cited Op. Br. p. 157.

in *United States v. Bridges*,⁷⁸ and rejected by the United States District Court for the southern district of New York in *United States v. Foster*.⁷⁹ See also *Wong Yim v. United States*, decided by this Court.⁸⁰ Appellees rely on *Thiel v. Southern Pacific Co.*, 328 U.S. 217 (1946). (Brief, p. 85.) As held in the later phases of the *Thiel* case, *supra*, the opinion in 328 U.S. only proscribes deliberate *exclusion* of an economic group.⁸¹

In an endeavor to show exclusion of an economic group appellees attempt to set up an arbitrary classification of farm laborers. (Brief, pp. 24, 81, 83.) The Court below made no such classification. *Fay v. New York*⁸² does not support such classification. At most it suggests a classification composed of union members and wage earners who bargain collectively, of whom there were at least nine on the grand jury list.⁸³ Hence no exclusion of an occupational group classifiable as such was shown, *a fortiori* no deliberate exclusion of such a group. The record shows that the Maui County jury commissioners did not reject any person because of his race, occupation or economic status. (R. 720-721, 791, 914.)

⁷⁸86 F.Supp. 922, 931 (1949).

⁷⁹83 F.Supp. 197, 205 (1949).

⁸⁰118 F.2d 667 (C.A. 9th, 1941), cert. denied 313 U.S. 589.

⁸¹169 F.2d 30 (1948), cert. denied 335 U.S. 872, affirming 67 F. Supp. 934 (1946). See also Op. Br. p. 158.

⁸²332 U.S. 261, 293 (1947), cited by appellees, Brief, p. 83.

⁸³Union members Ito (R. 729), Saka (R. 731), Muroki (R. 1037), Rezents (R. 734), Correia (R. 736), and Alu (R. 1036), and three non-union wage earners, Cornwall, Iziku (or Ajifu), and Ayers (R. 1439). But the Court included three of the union members in the employer-entrepreneur group. (Op. Br. p. 156.)

The Court found deliberate weighting, not deliberate exclusion, and based its finding of deliberate weighting on the testimony of Jury Commissioner Pombo. It must be remembered that the Court below was not sitting in Maui County. Nor did the Court have the opportunity usually enjoyed by a trial Court of judging the demeanor of the witness as well as his words; Jury Commissioner Pombo was not on the stand, his testimony having been stipulated into the record, subject to objections to the entire line of testimony concerning the grand jury. (No. 12301, pp. 83-84, R. 1130-1132.) By its misunderstanding of one small bit of Mr. Pombo's testimony, the Court deduced that Mr. Pombo, not a haole himself according to his own classification which is accepted by the Court and appellees (Brief, p. 78, R. 500) was prejudiced in favor of haoles.⁸⁴ From Mr. Pombo's opinion that men in business had better heads on them,⁸⁵ the Court deduced that Mr. Pombo, for many years a champion of the laboring man and an old-time Democrat (R. 804-805), was prejudiced against laboring men.

Since there were a substantial number of wage earners and union members on the grand jury list, Mr. Pombo's testimony has no more significance than the evidence in the *Thiel* case, decided by this Court,

⁸⁴The testimony on which the Court relied appears at R. 830-831, is quoted by the Court at R. 504, note 98, and is reviewed in the Opening Brief, p. 159. Cf. Mr. Pombo's testimony at R. 809-810, 848-849, 875.

⁸⁵The testimony on which the Court relied appears at R. 855, is quoted by the Court at R. 505, and is reviewed in the Opening Brief, pp. 159-160.

where it appeared that half the places on the list were assigned by the clerk to executives or owners of business, and the other half to salaried employees and daily wage earners alike.⁸⁶ See also *Local 36 v. United States*, decided by this Court, where the names were derived half from old jury lists and half from sources not representative of lower income groups, such as social registers, the telephone book, and lists submitted by various clubs.⁸⁷

CONCLUSION.

The decrees below, if permitted to stand, would have the effect of authorizing the District Court of Hawaii to interrupt the administration of criminal justice in the territorial Courts to a point where the law enforcement machinery could not function. The decrees were entered in direct violation of the act of Congress and are contrary to settled principles of equity which deny to the federal Courts the power to interfere in criminal proceedings in state and territorial Courts. For the reasons stated above and for the reasons more fully set forth in our opening brief the decrees below should be reversed and the cases

⁸⁶See 67 F.Supp. at p. 939, affirmed 169 F.2d 30, *supra*.

⁸⁷See 70 F.Supp. at pp. 791-792, affirmed 177 F.2d 320, *supra*.

remanded to the District Court with directions to
dismiss the complaints.

Dated, Honolulu, T.H.,
August 9, 1950.

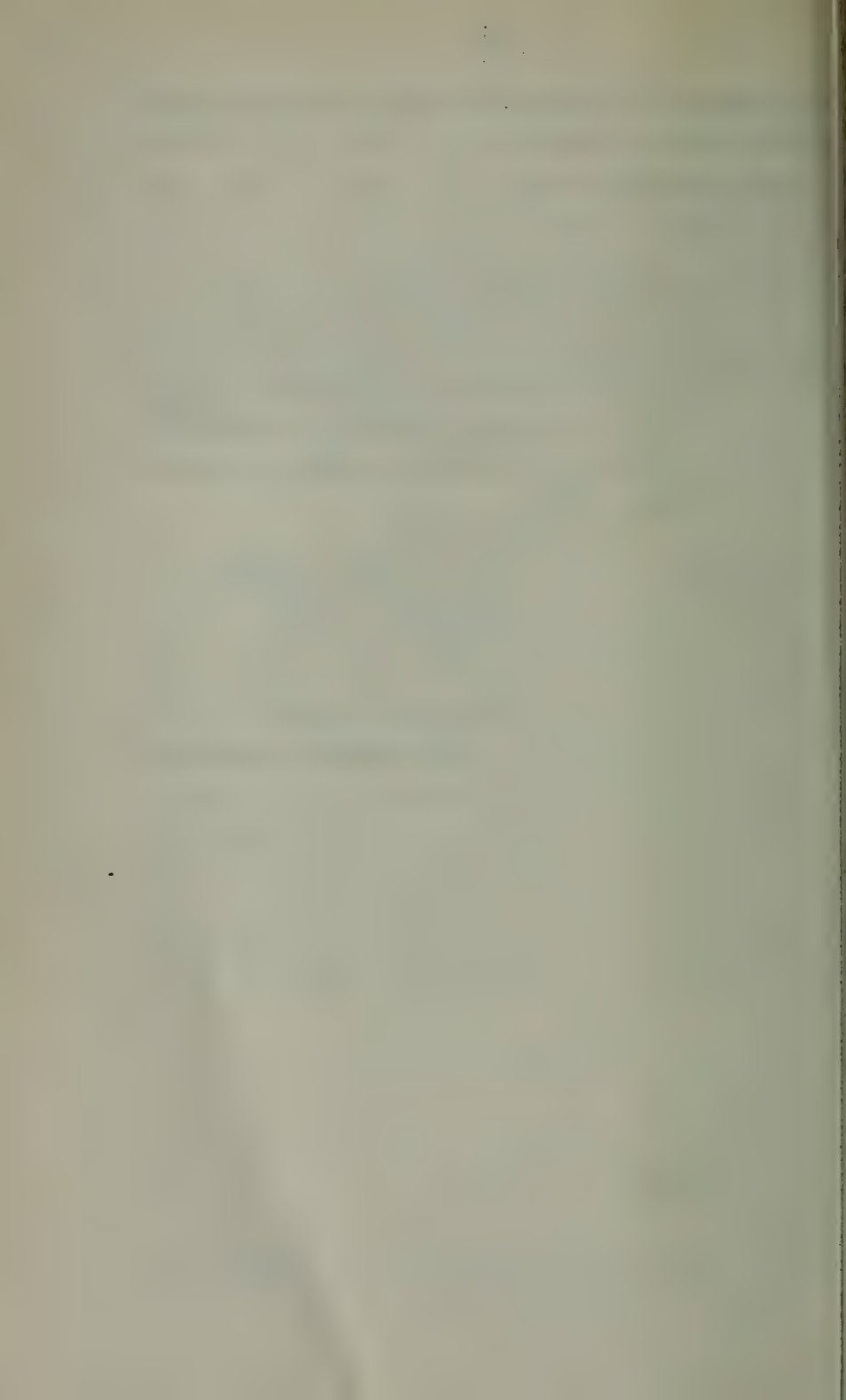
Respectfully submitted,
WALTER D. ACKERMAN, JR., individually and
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Hawaii, Appellant in Nos. 12300 and 12301,
and JEAN LANE, individually and as Chief
of Police of the County of Maui, Appellant
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IN THE
United States Court of Appeals
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WALTER D. ACKERMAN, JR., individually
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vidually and as Chief of Police of the
County of Maui,

Appellants,

vs.

INTERNATIONAL LONGSHOREMEN'S AND
WAREHOUSEMEN'S UNION, a voluntary
unincorporated association and labor
union, et al.,

Appellees.

No. 12300

WALTER D. ACKERMAN, JR., individually
and as Attorney General of the Terri-
tory of Hawaii,

Appellant,

vs.

INTERNATIONAL LONGSHOREMEN'S AND
WAREHOUSEMEN'S UNION, a voluntary
unincorporated association and labor
union, et al.,

Appellees.

No. 12301

Upon Appeal from the United States District Court
for the Territory of Hawaii

APPELLEES' PETITION FOR REHEARING

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Appellees.

No. 12301

Upon Appeal from the United States District Court
for the Territory of Hawaii

APPELLEES' PETITION FOR REHEARING

Appellees respectfully request the Court to recon-
sider its decision entered herein on February 28,

1951,¹ and to grant appellees a rehearing in this case on the following grounds:

I

THE COURT'S DECISION IS IN CONFLICT WITH THE DECISION OF THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT IN *Cooper v. Hutchinson*, DECIDED JULY 1950, AND WITH THE PROVISIONS OF SECTION 1797 OF THE CIVIL RIGHTS ACT OF MARCH 1, 1875, AS INTERPRETED BY THE UNITED STATES SUPREME COURT.

The Civil Rights Act and Injunctive Relief

Section 1797 of the Civil Rights Act of March 1, 1875, 8 U.S.C.A., Section 43, provides as follows:

Every person who, under color of any statute, ordinance, regulation, custom or usage, of any state or territory, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress.

On its face, this section authorizes *injunctive* relief in that class of cases in which, under color of state or territorial law, persons are deprived of rights, privileges or immunities secured by the Constitution and laws of the United States.

¹ Extension of time to April 25, 1951, granted by Court to file petition for rehearing.

Section 1797 of the Civil Rights Act, expressly authorizing the granting of injunctive relief in cases within its scope, is a statutory exception within the provisions of Section 2283 of Title 28. The United States Supreme Court by inference effectively so held in *Hague v. C.I.O.*, 307 U.S. 496.² Recently, the United States Court of Appeals for the Third Circuit, in *Cooper v. Hutchinson*, 184 F.(2d) 119, succinctly so held in a case involving the question of the stay of further proceedings in a criminal prosecution in the state of New Jersey. That court said:

² This Court found a distinction on the facts between the *Hague* case and this case, saying that in the *Hague* case it appeared that plaintiffs, seeking to hold peaceful meetings and to distribute literature, were threatened with arrest under the void Jersey City ordinance and their associates had been arrested and carried out of the city. The same pattern of deprivation of rights and abuse of authority under color of law was shown in these cases. It was shown that a number of persons of the class on behalf of whom the action was brought had been arrested under the void statutes, that after the termination of the strike in question, the charges against them had been dropped for lack of evidence; that persons not even present were arrested, held and indicted; that a person whom the police thought was not a union member was released upon that sole ground; that the pineapple strike had been broken by the mass arrests under the 20-year felony statute; that the harsh and discriminatory treatment by law enforcement officers accorded the members of the union by the continued selection of the unlawful assembly and riot statute had forced the members of the union employed as longshoremen to refrain from striking, because of the pattern and policy of abuse shown in past labor disputes.

The Court also distinguished the *Hague* case from the instant case by stressing that the conduct of all the plaintiffs in that case was lawful. The commission of a criminal offense does not bar relief under the Civil Rights Act for deprivation of constitutional rights suffered in the process. A person guilty of murder is entitled to the full benefit of his constitutional rights. Surely a minor infraction of the criminal law does not absolve the officers of a state or territory from the observance of the Constitution.

But appellants say that their right to assert a claim under Section 1 of the Civil Rights Act of 1871 is not dependent upon the prior pursuit of relief under state law. That is correct. *Lane v. Wilson*, 1939, 307 U.S. 268, 274-275, 59 S. Ct. 872, 83 L.Ed. 1281. We are not here governed by the rule of the habeas corpus cases to the effect that the state law processes must be exhausted before there can be resort to a federal court. And the provision in the Judicial Code forbidding the use of the injunction against state court action has a stated exception when a federal statute allows it, as it does here.¹¹

¹¹ 28 U.S.C.A. § 2283 (1946 Supp. III): "A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments." The Civil Rights Act provision relied upon here expressly provides for a "suit in equity" by the aggrieved party. Rev. Stat. § 1979 (1875), 8 U.S.C.A. § 43.

The Relief Sought and Granted Involves More Than Pending Criminal Prosecutions

This Court found it unnecessary to decide whether the District Court was prohibited from granting injunctions in these cases by Section 2283 of Title 28, and bottomed its decision on its ruling "that equity jurisdiction does not extend to enjoining pending criminal prosecutions."

This ruling was predicated on the Court's conclusion that the appellees sought and the District Court granted relief only against pending criminal prosecutions, and hence that the relief does not sound in the

future. This is not correct. The complaint sought declaratory relief, and the evidence introduced and the facts found showed a pattern and policy of violations of the rights under criminal prosecutions both past and present, and a continuous threat of deprivation of rights if appellees sought to use their constitutional and federally protected right to strike and to engage in picketing activities.

The decree of the District Court shows that the relief granted was more than relief against pending prosecutions. Thus, paragraph 10 of the District Court's decree of March 29, 1949, declared the unlawful assembly and riot act void as unconstitutional (R. 548). Paragraph 11 restrained the persons bound by the decree and their successors in office from proceeding with the prosecution commenced on July 16, 1947 against certain named plaintiffs, under any complaint or indictment based on the unlawful assembly and riot statute. Paragraphs 12 and 13 contained similar provisions with respect to other plaintiffs. At the time the decree was entered, there were no indictments pending in the courts of the Territory against the plaintiffs in No. 12,300, and the indictment No. 2365 in No. 12,301 was held void because of the manner in which the grand jury was constituted. Under the federal Constitution, as well as under Territorial law, these plaintiffs could not be prosecuted for a felony except by indictment. Not only do the complaint and the decree of the court show that the scope of the relief sought was more

than against pending criminal prosecutions, but the proof tendered and the findings of the court indicate that the subject matter of the controversy involved more than pending prosecutions.

The United States Supreme Court, in *Arthur St. John v. Wisconsin Employment Relations Board*, 95 L.Ed. Adv. Sheets 398, 400, described the same sort of relief sought here as "injunctive and declaratory relief looking to the future."

The declaratory and injunctive relief granted by the District Court as to the unconstitutionality of the statutes and as to the violation of appellees' right to a fair and impartial grand jury selected in accordance with constitutional principles enunciated and clearly defined by the United States Supreme Court, is the same kind of declaratory relief granted by the United States Court of Appeals for the Fifth Circuit in *City of Birmingham v. Monk*, 185 F.(2d) 259. Indeed, in the instant cases, as in the *Monk* case, the challenged laws were found to be void under decisions of the U. S. Supreme Court.

In the *Monk* case, the court said:

. . . It is true, as urged by appellants, that the State and its municipalities in the exercise of those police powers that were reserved at the time of the adoption of the Constitution has wide discretion in determining its own public policy and what means are necessary for its own protection and properly to promote the safety, peace, public health, convenience and good

order of its people. But it is equally true that the police power, however broad and extensive, is not above the Constitution. When it speaks its voice must be heeded and it is the obligation of this court so to declare. But we need not labor the point for the precise question presented here is foreclosed by the decisions of the courts, both Federal and State. (Citing cases.)

If the decrees of the District Court had, on the basis of the facts found and its determinations of law, granted only declaratory relief, the result would have been the same,³ as the territorial courts would have been bound by the determination of federal law in a civil rights case of which the District Court has original jurisdiction.

Under Civil Rights Act, District Court Had Jurisdiction to Enjoin Pending Prosecutions

Should this Court, however, remain firm in its conviction that the relief sought and granted extends only to pending prosecutions, nevertheless the Civil Rights Act confers power on the District Court, where exceptional circumstances exist and irreparable injury is found, to enjoin pending criminal prosecutions.

It is impossible, as this Court sought to do, to separate the generally stated rule against enjoining

³ The Supreme Court in effect so held even in *Ex Parte Young*, 209 U.S. 123, and *Cline v. Frink Dairy Co.*, 274 U.S. 445, which were not suits brought under the Civil Rights Act and in which therefore Section 379 of the old Judicial Code by its terms prohibits staying state court proceedings.

pending criminal prosecutions, and Section 2283, of the New Judicial Code, formerly Section 379 of Title 28. The prohibition of this section has been a part of the Judicial Code since the creation of courts of the United States. It has been said that the distinction drawn by federal courts between threatened and pending criminal prosecutions arose in order to evade a direct collision with the language of the prohibition on the theory that prosecutions merely threatened and not yet brought were not "state court proceedings" within the meaning of the prohibition of the statute.⁴

The language of the present Section 2283 excepts from its scope injunctions "expressly authorized by Act of Congress." It was modified to restore the law as it existed prior to *Toucey v. New York Life Ins. Co.*, 314 U.S. 118, and to obviate any conflict with statutes providing specifically for injunctive relief.⁵

The cases cited by this Court in support of its holding that there are no exceptions to the rule that equity jurisdiction does not extend to enjoining pending criminal prosecutions were not brought under the Civil Rights Act.

No discussion of a distinction between threatened and pending criminal prosecutions appears in any civil rights case because the Civil Rights Act is a statutory exception to Section 2287 of Title 28, en-

⁴ Encyclopedia of Federal Procedure, Vol. 13, Sec. 6559, Sec. 6675.

⁵ Moore's Commentary on the U.S. Judicial Code, 1949, Sec. .03 (49), page 395 (ff).

grafted by Congress years after the original enactment of the prohibition. In civil rights cases, the question is solely that of the propriety of the exercise of jurisdiction, and this turns on the existence of exceptional circumstances and irreparable injury. *Douglas v. Jeannette*, 319 U.S. 157.

Thus, in that case, the Supreme Court said:

... Hence the arrest of the federal courts of the processes of the criminal law within the states and the determination of questions of criminal liability under state law by a federal court of equity are to be supported only on a showing of danger of irreparable injury "both great and immediate."

One of the reasons the court gave for withholding the equitable hand of the court was that the lawfulness or constitutionality of the statute or ordinance upon which prosecution is based may be determined as readily in the criminal case as in a suit for an injunction. In these cases, obviously the legal remedy is not as complete and efficient as equity can afford. See *Terrace v. Thompson*, 263 U.S. 197. It was shown that the appellees had tested every issue of law, including the constitutionality of the unlawful assembly and riot act and the legality of the grand jury, in the courts of the Territory, and had been denied their rights. Since the test of the constitutionality occurred in a statutory interlocutory appeal to the Supreme Court of the Territory, from which

no appeal lies to this Court, the plaintiffs were bound by the law of the case established by the Supreme Court in *Territory v. Kaholokula*, 37 Haw. 625, and could not again raise the question successfully until an appeal finally reached this Court. That the legal remedy was not as speedy and efficient as that which equity affords is therefore clear.

In *Douglas v. Jeannette*, the reason the Supreme Court stayed its hand was that the statute attacked as unconstitutional had on the same day been declared unconstitutional. The court had no cause to believe that the courts of the Commonwealth of Pennsylvania would refuse to abide by the ruling of the court. That this is the proper interpretation of the court's decision appears from *St. John v. Wisconsin Employment Relations Board*, 95 L.Ed. Adv. Sheets 398, where an exactly similar situation arose. On the same day that the Supreme Court decided this case, in *Amalgamated Association of Street, Electric Railway and Motor Coach Employees of America, Division 998 v. Wisconsin Employment Relations Board*, 95 L.Ed. Adv. Sheets 383, it held unconstitutional as in conflict with the National Labor Relations Act, the Wisconsin state statute prohibiting strikes against public utilities. The court therefore denied injunctive and declaratory relief in the *St. John* case against the enforcement of the statute in the future, saying:

In view of today's decision in Nos. 329 and 438, ante, the later case involving the very parties to this action, "we find no ground for supposing

that the intervention of a federal court in order to secure appellants' constitutional rights will be either necessary or appropriate."

Douglas v. Jeannette, 319 U.S. 157, 165.⁶

In *Cooper v. Hutchinson*, *supra*, where a stay of pending state court criminal action was sought under the Civil Rights Act, in order to secure the constitutional right to counsel of the defendants' choice, the Circuit Court of Appeals, after examining the facts, declared the extent and scope of the defendants' rights to counsel, but withheld injunctive relief to afford the state of New Jersey, in accord with its opinion, an opportunity to remedy the deprivation *on interlocutory appeal*. The court said:

We think the ends of justice in this case will be best preserved by the following action: We shall vacate the judgment of the trial court and remand this case to the District Court for the District of New Jersey. We shall instruct the trial court to retain jurisdiction in this suit for an injunction pending *interlocutory determination*, by New Jersey courts, of the appellants' rights to the professional services of their lawyers who were admitted to handle their cases and whose representation, it is alleged, was summarily cut off. If the appellants' allegations are true, we have little doubt that the New Jersey courts, if not the defendant himself, will rectify

⁶ The facts appearing in these cases are analogous to the facts in the instant case. The appellants in those actions showed that by the use of the statute as well as punishment for criminal contempt under the statute, they had been denied the right to strike given by the federal Labor Management Relations Act.

this deprivation of constitutional rights once the situation has been brought to their attention. In that event, this proceeding may be dismissed as moot. (*Italics supplied.*)

In these cases, the Supreme Court of the Territory had by interlocutory appeal passed on the issue of constitutionality of the unlawful assembly act, and had failed to accord relief from the deprivation of rights complained of.

Rule of Removal Cases Inapplicable to Suits Under Civil Rights Act

The removal cases, such as *Kentucky v. Powers*, 201 U. S. 1, are not applicable nor is the same strict test required where United States district courts are given original jurisdiction as in Section 43 of Title 8, and Section 1343 of the New Judicial Code.⁷

A Cause of Action Under the Civil Rights Act Was Made Out Within Principles Defined In *Screws v. United States*

In *Screws v. United States*, 325 U. S. 91, in upholding the criminal conspiracy section of the Civil Rights Act—which is in *pari materia*⁸ with the section affording civil relief—the Supreme Court said that “to deprive a person of a right which has been made specific either by express terms of the Constitu-

⁷ *Screws v. U. S.*, 325 U.S. 91, 65 S. Ct. 1031, 89 L.Ed. 1495. Moore's Commentary on the United States Judicial Code, 1949, Section .03 (39), pages 257-258.

⁸ *McShane v. Maldoven*, 179 F. (2d) 1016, 1020 (C.C.A. 6); *Picking v. Pennsylvania R.R.*, 151 F. (2d) 240 (C.C.A. 3), cert. den. 332 U.S. 776.

tion or laws of the United States or by decisions" of the Supreme Court interpreting them supplied the specific intent necessary to constitute wilful deprivation of rights. A local officer, the Court said, who persists in enforcing a type of ordinance which the Supreme Court has held invalid as violative of the guarantees of free speech or freedom of worship, or a local official who continues to select juries in a manner which flies in the teeth of decisions of the Supreme Court knows exactly what he is doing.

He violates the statute not merely because he has a bad purpose, but because he acts in defiance of announced rules of law. He who defies a decision interpreting the constitution knows precisely what he is doing.

Appellees showed that the unlawful assembly and riot act of the Territory parallels in every respect, except the death penalty, the Riot Act of George the First, which the Supreme Court in *Bridges v. California*, 314 U. S. 252, specifically cited as a measure which the Bill of Rights prohibited the American Congress from passing.

The conspiracy act on its face falls clearly within that type of vague and indefinite statute which the Supreme Court struck down in *United States v. L. Cohen Grocery Co.*, 255 U. S. 81, on the ground that

to attempt to enforce the section would be the exact equivalent of an effort to carry out a statute which in terms merely penalized and punished all acts detrimental to the public in-

terest when unjust and unreasonable in the estimation of the court and jury.

Appellees met with exactitude the quantum of proof held sufficient to show a deliberate and substantial exclusion from the grand jury list of persons on account of race, in a long line of cases from *Strauder v. West Virginia*, 100 U. S. 303, through *Patton v. Mississippi*, 332 U. S. 463, and as to exclusion of wage earners, the test laid down in *Thiel v. Southern Pacific Co.*, 328 U. S. 217. Appellees showed that the 1947 grand jury was illegally composed within the principles laid down in *Fay v. New York*, 332 U. S. 261.

These specific decisions and matters had been presented to the Territorial courts, which had refused to give them effect.

It is respectfully submitted that the Court in holding that the court did not have jurisdiction to grant the injunctions and that the suits should be dismissed emasculates the Civil Rights Act and denies appellees of the remedy to which they are entitled under that Act, and conflicts with the decisions of other circuits and of the Supreme Court cited above.

II

ON THE RECORD IN THESE CASES, THE COURT ERRED IN SETTING ASIDE THE DISTRICT COURT'S FINDINGS OF FACT IN RESPECT TO EXCEPTIONAL CIRCUMSTANCES AND IRREPARABLE INJURY FOR THE REASON THAT THESE FINDINGS ARE SUPPORTED BY SUBSTANTIAL EVIDENCE.

Power of This Court on Findings of Fact

It is well settled that under Rule 52(a) of the Federal Rules of Civil Procedure, 28 U.S.C.A., that this Court cannot set aside the trial court's findings of fact unless the findings are so lacking in evidentiary support as to be clearly erroneous. This principle was recently stated by the United States Court of Appeals for the Eighth Circuit in *U. S. Cartridge Co. v. Powell*, 185 F.(2d) 67, as follows:

From all of the evidence on the subject, it is not unlikely that we, sitting as a trial court, might have reached a different conclusion than the trial court reached on the propriety of the classification of these plaintiffs, but as we have repeatedly pointed out above and repeatedly held in reported cases, by the express direction of the Rules of Civil Procedure, 28 U.S.C.A., we may not set aside a finding of fact of a trial court unless that finding is so lacking in evidentiary support as to be clearly erroneous. In this instance we find sufficient conflicting inferences which may be drawn from the evidence to preclude us from holding that the trial court's finding was clearly erroneous.

See also *Imperial Assurance Co. v. Supornick*, 184 F.(2d) 930; *Fanish v. Fanish*, 195 F.(2d) 425.

**The Findings as to Irreparable Injury Are
Supported by Substantial Evidence**

This Court first rejected the District Court's finding of irreparable injury that "all collective bargaining in the Territory of Hawaii is substantially affected by the two statutes as well as the prosecutions conducted or about to be carried on thereunder," and the analogy the District Court drew to the facts held by the United States Supreme Court in *AFL v. Watson*, 327 U. S. 582, to make out a showing of irreparable injury.

The findings of the trial court in respect to the facts concerning the incidents out of which the complaint of deprivation of constitutional rights arose are unique in that the District Court in every instance of disputed facts accepted appellants' version of the facts. In other words, construing every fact and circumstance concerning these incidents against appellees, the court found appellees entitled to relief. In support of its finding of irreparable injury, it found in part:

That the union has spent in excess of one-third of a million dollars in Hawaii since 1944 in organizing 30,000 workers in the sugar, pineapple and other industries; that large sums of money are spent monthly in the administration and servicing of the locals; that the money is

contributed by the members through monthly dues.

That the purpose of the union is to improve the wages, hours and working conditions of its members in these industries; that the union and its members have no way of achieving their objectives except by striking, if collective bargaining and voluntary mediation fails to settle disputes because the employers of the members of the appellee union all refuse to submit contract issues involving wages to arbitration.

That wages for common labor had been increased from \$1.84 a day, fixed by the federal government in 1943, to which a 15% bonus was added, to in excess of eight dollars a day under existing union contracts.

That the fear generated by the mass arrests made by appellants under color of the unlawful assembly and riot statutes against the individual appellees in these cases for minor disturbances on picket lines has seriously weakened the ability of the union to strike.

That mass arrests during the pineapple strike, under color of these statutes, for picket line disturbances broke the strike and demoralized many of the workers, who left the union; that after the strike, membership on the island of Lanai, where the mass arrests occurred, dropped from 1300 to 800.

That the unlawful assembly and riot acts substantially affected the course of labor-management relations in Hawaii as the union felt it would be suicide to strike for higher wages in the face of the consistent established

use of the 20-year felony of unlawful assembly and riot for minor disturbances on picket lines.

That during the sugar strike, 21 members of the union were charged with and indicted for unlawful assembly and conspiracy; that the charges were dropped two months after the Territory-wide strike was over and nolo contendere pleas accepted to misdemeanor assault and battery charges.

That during the pineapple strike, 83 members of the union were arrested; that the charges were dropped, after the strike, for lack of evidence. Appellees introduced evidence to show that these arrests were made on the defendants in the case held for five hours purportedly for violations of the unlawful assembly and riot act, and that finally a charge of obstructing the highway was made and dropped after the strike for lack of evidence.

That the mere existence of the statute has been used by Territorial courts to justify sweeping injunctions against peaceful picketing except as limited to three.

That excessive bail was exacted in these cases; that mass arrests were made in many instances where no evidence of even presence at the scene of the alleged incident existed, other than pictures concededly taken at the scene both before and after the incidents occurred; that the reported cases indicated that the unlawful assembly and riot statutes had been used only against labor while engaged in labor disputes, since Hawaii became a part of the United States.

... The 1946 sugar strike commenced on September 1, 1946 and lasted until November 19, 1946, except at Pioneer Mill Company, Lahaina, Maui, where it continued until January 2, 1947 because that company discharged for purported violations of its house rules ten of its employees upon their being charged with unlawful assembly, riot and conspiracy. . . .

Surely, the breaking of one strike—the pineapple strike—by the mass arrests under these statutes and the prevention of a strike to improve conditions of members of the union engaged in the longshore industry standing alone are sufficient to justify a finding of irreparable injury.

These strikes were lawful strikes protected by federal labor laws. They were not comparable in any way to the unlawful work stoppages in *International Union v. Wisconsin Board*, 336 U. S. 245. They affected not only the comparatively few members implicated in trivial violations of law but all of the union's 30,000 members on whose behalf the action was brought.

Bad Faith in Prosecution Constitutes Exceptional Circumstances Justifying Injunction

The Court likewise rejected the holding of the District Court that bad faith in criminal prosecutions constitutes in law an exceptional circumstance justifying the injunction granted. As pointed out

above, the United States Supreme Court in *Screws v. United States, supra*, held that bad motives and abuse of power under color of law on the part of law enforcement officers justified conviction under the criminal conspiracy sections of the Civil Rights Act. *A fortiori*, it would constitute grounds for injunction under the civil remedy provision.

In *McShane v. Maldoven, supra*, the United States Court of Appeals for the Sixth Circuit held that a complaint for damages under the Civil Rights Act states a cause of action where it alleged that state officers and others combined to deprive appellant of rights secured by the Fourteenth Amendment by unlawfully arresting and imprisoning her and subjecting her to a fraudulent criminal trial under color of the laws of Michigan.

And in *Snowden v. Hughes*, 321 U. S. 1, the Supreme Court stated that a showing of wilful discrimination in the enforcement of state law, fair on its face, constituted denial of equal protection for which redress could be sought under the Civil Rights Act. *A fortiori* discrimination under an invalid law would likewise. See also, *Burt v. City of N. Y.*, 156 F.(2d) 791.

Finding of Bad Faith is Supported by Substantial Evidence

This Court likewise rejected the finding of the District Court that on the basis of the record before it, the criminal prosecutions were carried on by ap-

pellants for the purpose of attack upon a labor movement rather than for the ends of justice. This conclusion of fact was reached, not only on the basis of the enumeration of facts recited by this Court in its opinion, but on the basis of the whole record.

The conclusion of bad faith seems inescapable when 75 persons are indicted for a 20-year felony as a result of an incident where police officers present read the petty misdemeanor statute prohibiting loitering, congratulated the people present on wanting order and stated that four or five might be charged with loitering to make a test of that act!

The conclusion of bad faith would seem to be justified solely on the facts surrounding the return of indictment. Seventy-five working men were indicted by a grand jury composed in direct contravention of clearly defined principles laid down by the United States Supreme Court, returned at a time when the federal court had enjoined the submission of facts to the same grand jury in Civil 828 under identical facts and circumstances, including its illegal composition.

It is respectfully submitted that the District Court's findings of fact of exceptional circumstances are supported by substantial evidence and that its conclusion of law that these exceptional circumstances warranted the issuance of the injunctions granted.

Dated: Honolulu, T.H., April 25, 1951.

Respectfully submitted,

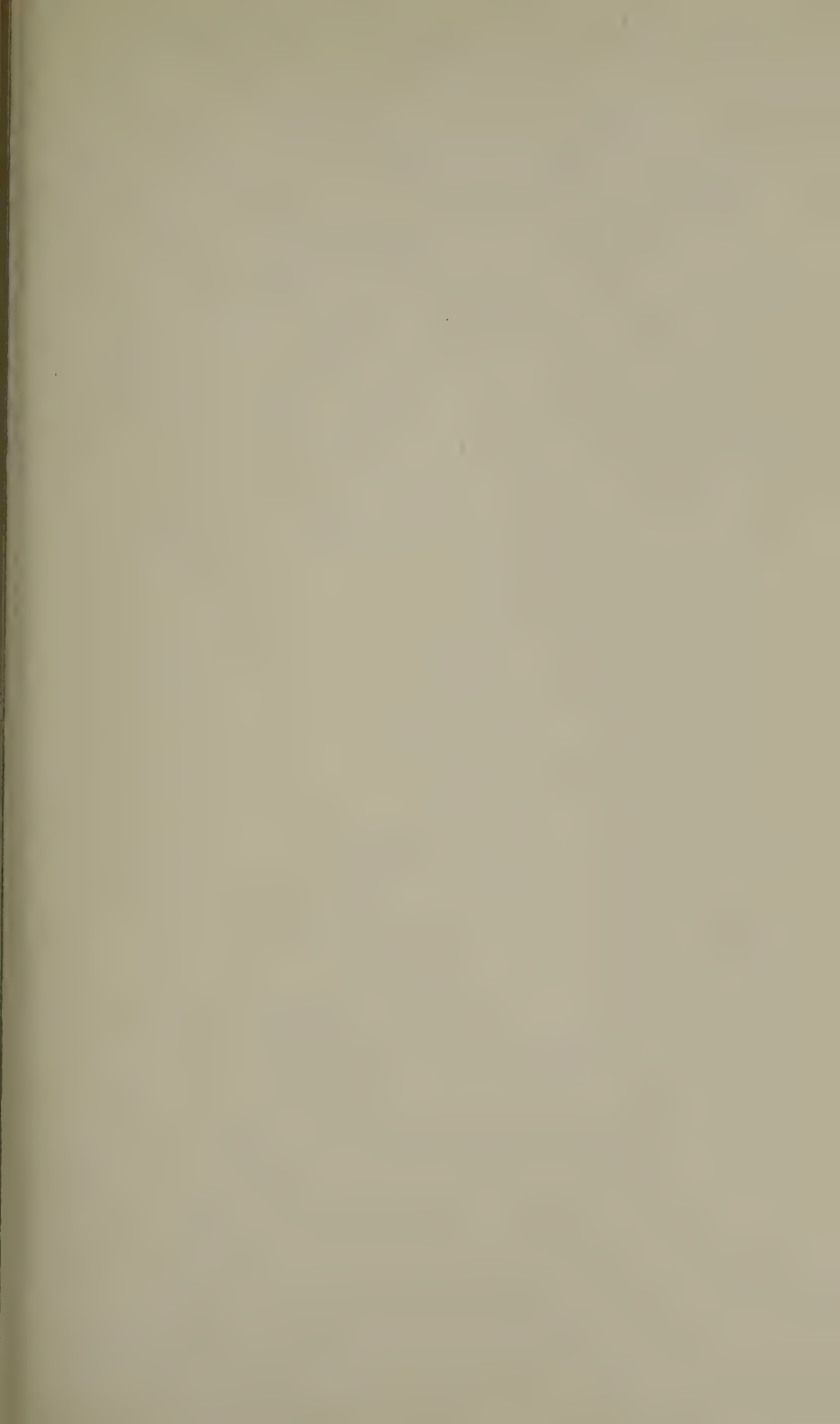
BOUSLOG & SYMONDS

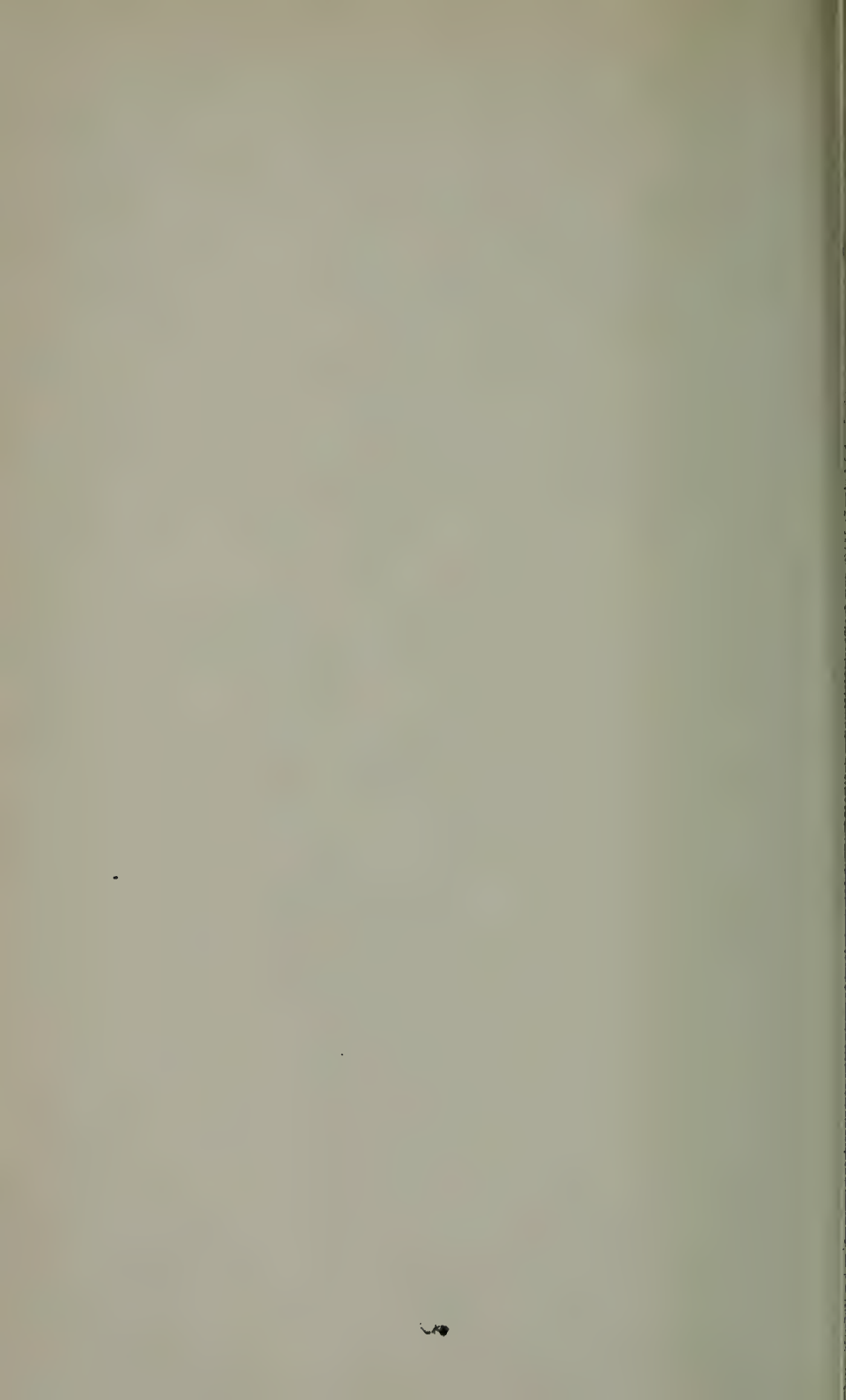
By

HARRIET BOUSLOG
Attorneys for Appellees

I hereby certify that the within Petition for Re-hearing is not interposed for purposes of delay.

HARRIET BOUSLOG
Attorney for Appellees





No. 12306

United States
Court of Appeals
For the Ninth Circuit.

UNITED STATES OF AMERICA,
Appellant,
vs.

C. E. BONNELL, Doing Business as The Bonnell
Construction Company, and ROY T. EARLEY,
Doing Business as The Roy T. Earley Com-
pany, Joint Adventurers Under the Trade
Name of Bonnell Construction Company of
Bremerton,
Appellees,
and

C. E. BONNELL, d/b/a The Bonnell Construction
Company, and ROY T. EARLEY, d/b/a Roy
T. Earley Company, etc.,
Appellants,
vs.

UNITED STATES OF AMERICA,
Appellee.

Transcript of Record

Appeals from the United States District Court for the
Western District of Washington,
Southern Division

OCT 10 1946

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UNITED STATES OF AMERICA,
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C. E. BONNELL, d/b/a The Bonnell Construction
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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Tacoma, Washington

Attorneys for Appellees.

United States District Court, Western District
of Washington, Southern Division

No. 1146

UNITED STATES OF AMERICA, and JOHN D.
GOODLOE, HENRY T. BODMAN, HARVEY
J. GUNDERSON, HARLEY HISE and
HENRY A. MULLIGAN, Directors of the
Reconstruction Finance Corporation,
Plaintiffs,

vs.

C. E. BONNELL, d/b/a THE BONNELL CON-
STRUCTION COMPANY and ROY T.
EARLEY, d/b/a THE ROY T. EARLEY
COMPANY, Joint Adventurers under the trade
name "BONNELL CONSTRUCTION COM-
PANY OF BREMERTON,"

Defendants.

COMPLAINT

Come now the plaintiffs, by J. Charles Dennis,
United States Attorney for the Western District of
Washington, and Guy A. B. Dovell, Assistant United
States Attorney for said district, and for cause of
action against the above named defendants, allege,
to-wit:

I.

That the United States of America is a corpora-
tion sovereign, and that John D. Goodloe, Henry T.
Bodman, Harvey J. Gunderson, Harley Hise, and

Henry A. Mulligan bring this action in their official capacities as directors of the Reconstruction Finance Corporation, a government chartered corporation, against the above named defendants, pursuant to Sixth Supplemental National Defense Appropriation Act of 1942, Renegotiation Act, Section 403(c) 56, Stat. 245, as amended, to recover from said defendants excessive profits, as the same are more particularly hereinafter set forth.

II.

That defendant C. E. Bonnell is now and was at all times hereinafter mentioned a resident of Pierce County in the Southern Division of the Western District of Washington, and at such time was an individual doing business under the firm name and style of Bonnell Construction Company.

That defendant Roy T. Earley is now and was at all times hereinafter mentioned a resident of Pierce County, in the Southern Division of the Western District of Washington, and at such time was an individual doing business under the firm name and style of the Roy T. Earley Company.

III.

That on or about April 24, 1942, the said defendant C. E. Bonnell, d/b/a The Bonnell Construction Company contracted with the War Department of the United States to build a certain number of housing structures at Bremerton, Washington, within a specified time, and thereafter in order to

perform said contract entered into a joint venture agreement with said defendant Roy T. Earley, d/b/a The Roy T. Earley Company, wherein it was agreed that said job would be performed under the trade name of Bonnell Construction Company of Bremerton, and said contracting defendants in the joint venture should share in the performance of said job and equally in the profits before Federal income taxes, and by which agreement said C. E. Bonnell constituted said Roy T. Earley his agent for all purpose of said War Department contract, bearing serial number W-869-Eng.-6202, a copy of which agreement is hereto attached, marked Exhibit "A" and made a part hereof.

IV.

That acting in compliance with law and pursuant to duly delegated authority, the RFC Price Adjustment Board duly commenced renegotiation proceedings with the defendants and duly determined, on or about May 17, 1945, that of the profits realized by the defendants on said Contract No. W-869-Eng.-6202, the sum of \$55,000.00 represented excessive profits. And on or about said date, the said RFC Price Adjustment Board, in compliance with law and pursuant to duly delegated authority, acting through its chairman Mr. G. B. Coit, issued a unilateral determination and order, a copy of which is attached hereto, marked Exhibit B, and made a part hereof.

V.

That thereafter, on or about March 17, 1945, the Treasurer of the R.F.C. Price Adjustment Board, by registered mail, served upon said defendants, a letter of demand directed to said defendants to pay to said board said excessive profits of \$55,000.00, less the tax credit, if any, to which defendants might be entitled under the provisions of Section 3806 of the Internal Revenue Code, a copy of which demand is hereto attached, marked Exhibit C, and made a part hereof.

VI.

That the tax credit to which the defendants are entitled under said section 3806 of the Internal Revenue Code is in the sum of \$35,034.59, computed as aforesaid by the Commissioner of Internal Revenue.

VII.

That the said defendants have refused and still refuse to pay to the plaintiffs the said excessive profits of \$55,000.00 less the aforesaid tax credit, but that the United States has from time to time applied to said obligation the sum of \$7,076.45, out of funds which have at various times come due to the defendants and have been applied either to payment of interest which had therefore accrued or to reduction of the principal obligation, a statement of which is hereto attached, marked Exhibit "D" and made a part hereof. There remains due and owing to the plaintiffs a principal balance of

\$13,341.59, and interest thereon at 6% per annum from September 29, 1945.

Wherefore, plaintiffs pray for judgment against the defendants C. E. Bonnell and Roy T. Earley in the sum of \$13,341.59 plus interest thereon at the rate of 6% per annum from September 29, 1945, together with plaintiffs' costs herein, and for such other and further relief as to the court may seem just and proper.

/s/ J. CHARLES DENNIS,
United States Attorney

/s/ GUY A. B. DOVELL,
Assistant United States
Attorney.

EXHIBIT A
(Copy)

Agreement of Joint Adventure

This Agreement made this day of May, 1942, between C. E. Bonnell, doing business as Bonnell Construction Company, hereinafter referred to as "Bonnell," party of the first part, and Roy T. Earley, doing business as Roy T. Earley Company, hereinafter referred to as "Earley," party of the second part, Witnesseth:

The parties hereto are building contractors who have, for a long period of time, engaged in building construction in the Pacific Northwest and have organizations and equipment adapted to and suitable for the carrying out of construction projects.

Heretofore, Bonnell was awarded a contract by the United States, acting by and through the United States Engineers Corps, for the construction of approximately three hundred structures for the use of the 202nd Coast Artillery Corps, Anti-Aircraft, in the vicinity of Bremerton, Washington, which contract is known as contract No. and dated upon the day of, 1942, and which is made a part hereof by reference.

By the terms of said contract Bonnell is required to furnish to the United States a performance bond in the amount thereof. Bonnell has the experience and employee personnel and a substantial portion of the equipment necessary for the successful completion of said contract. He is, however, without sufficient funds to provide a performance bond or to pay for materials and labor necessary to be purchased or employed previous to the time that moneys are received under the contract from the United States.

Earley is able and willing to finance the performance of said contract and to furnish any and all accounting services in connection therewith for a percentage of the net profits, if any, from such contract, as hereinafter set forth.

In view of the foregoing facts and circumstances, it is Agreed that the parties hereto, as joint adventurers in this particular transaction, and in no other respect, will undertake the full performance of said contract upon the following terms and conditions:

1. Bonnell will manage and direct all construction operations in connection with the performance of said contract; not including, however, the operation of the accounting department thereof, and will hire and discharge, if necessary, any and all laborers, foreman or other persons reasonably required to aid and assist in the carrying out of such contract. For the services to be performed by Bonnell in connection with this venture he shall receive the sum of Four Hundred Dollars (\$400.00) per month, beginning upon the day of May, 1942, which shall be considered one of the labor costs of the undertaking and be charged up against the gross sums received before the division of net profits, as hereinafter set forth.

2. The parties hereto agree to sign an application for a performance bond and Earley will furnish the necessary indemnity or guaranty in order to secure the issuance of such a bond; the cost thereof, if any, sustained by Earley to likewise be charged as a proper cost in connection with the job. Bonnell will sign said bond without the joinder of Earley thereto.

3. Earley agrees to furnish all funds or credit which may be required to enable the contract to be performed. It is Agreed, however, that in this connection Earley shall furnish such necessary clerical help or accountants as may be reasonably required in connection with the performance of this contract and that all receipts and disbursements made shall be made under the supervision and control of such

person as may be designated by Earley. The reasonable and necessary salaries and wages of such clerical or accounting help so furnished by Earley shall be charged to the job and against gross receipts before the division of profits.

4. In the event that, previous to the full performance of said contract Bonnell shall die or become disabled so as to be unable to fully and completely manage and supervise said contract, then Earley may, at his option, take over the full management and control of the completion of the contract and that, in such event, he may designate or appoint either himself or some other person who shall perform the duties theretofore carried on by Bonnell and shall be paid therefor, as a cost to be charged against the job, the sum of Four Hundred Dollars (\$400.00) per month.

5. It is contemplated that Earley will furnish all office equipment stationery and other supplies in connection with the clerical and accounting department and that Bonnell will furnish certain machinery, tools and equipment necessary to be used in the performance of the contract. It is Agreed that a reasonable rental shall be charged by the parties against the job for the use of the personal property hereinbefore described and that each of them shall recover such reasonable rental from the gross receipts before division of profits.

6. In the event that it shall be found necessary to purchase any machinery, tools, equipment or

office supplies and equipment in order to complete said contract, then the same shall be deemed to be owned jointly by the parties and upon the completion of the job shall either be divided in a manner mutually agreed upon between the parties or else sold and the proceeds equally divided between the parties.

7. It is Agreed that said job will be performed under the trade-name of "Bonnell Construction Company of Bremerton" and that all funds advanced by Earley or any other person, firm or corporation in connection with said job and all moneys received from the Government in connection therewith, shall be placed in a special fund which shall be separate and apart from other funds of the parties hereto and shall not be subject to withdrawal or check except upon the signature or signatures of such person or persons as may be mutually agreed upon between the parties.

8. It is Agreed that after all labor, taxes, rentals, materials and other items of expense, including the salary of Bonnell, as aforesaid, and including also the salaries of persons designated by Earley and employed in the accounting department, have been paid in full, then the difference, if any, between the gross amounts received from the United States under said contract and said costs shall be disbursed as follows:

(a) There shall be paid therefrom to Earley from said funds an amount equal to all advances made by him in the course of the performance of the contract and, in addition thereto, an amount

equal to all interest paid by him upon funds borrowed by him and used in the performance of the venture.

(b) There shall be paid to each of the parties reasonable rental for the use of machinery and equipment, as provided in paragraph five hereof.

(c) Any sums remaining after said payments shall then be divided equally between the parties; that is to say, each of the parties shall receive fifty per cent (50%) of the net profits, before income taxes, which may accrue after the payments of the items aforesaid.

Executed in duplicate, the day and year first above written.

.....
.....

Doing business as Bonnell
Construction Company,
First Party,

.....

Doing business as Roy T.
Earley Company, Second
Party.

EXHIBIT B
(Copy)

RFC Price Adjustment Board
Determination of Excessive Profits

Whereas, C. E. Bonnell (doing business as Bonnell Construction Company), of Tacoma, Washing-

ton, has heretofore entered into a certain contract (hereinafter referred to as "said contract") with the United States of America (acting through the Secretary of War and the Corps of Engineers) numbered W869-ENG-6202, which is subject to renegotiation pursuant to Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as last amended July 14, 1943, and as affected by Title VII of the Revenue Act of 1943 so far as applicable (such Section 403 as so amended and affected being herein called "Section 403"); and

Whereas Roy T. Earley (doing business as Roy T. Earley Company), of Tacoma, Washington, has entered into an agreement of joint adventure with said C. E. Bonnell for the performance of said Contract, whereby said C. E. Bonnell and said Roy T. Earley became and were joint adventurers for the full performance of said Contract and for the sharing, upon the terms recited in such agreement of joint adventure, of the profits to be realized under said Contract; and

Whereas, There has been delegated by the Secretary of War by appropriate authority (under subsection (f) of Section 403) to the RFC Price Adjustment Board (herein sometimes called the "Board") and its duly authorized representative or representatives all of the power, authority and discretion necessary to the conduct of the renegotiation of, and the elimination of excessive profits realized under, said Contract; and

Whereas, Renegotiation has taken place between the Board on the one part and, on the other part, said C. E. Bonnell and said Roy T. Earley, joint adventurers for the performance of said Contract (and as such joint adventurers sometimes hereinafter referred to as "Contractor"), pursuant to the provisions of Section 403 and pursuant to such delegation, for the purpose of eliminating excessive profits realized by Contractor during its fiscal year ended December 31, 1942, under said Contract; and

Whereas, as a basis for said renegotiation the Board has considered certain financial, operating and other data, submitted by Contractor or obtained by the Board from governmental or other reliable sources, relating to the profits realized by Contractor during said fiscal year under said Contract; and

Whereas, Contract has been granted the opportunity to submit such information and to present such contentions as Contractor deemed material in determining the excessiveness of said profits and the renegotiability of said Contract, and due consideration has been given to the financial, operating and other data and information so furnished or obtained and each of the contentions so presented:

Now Therefore, Pursuant to the power, authority and discretion vested in the Secretary of War under the provisions of Section 403, as heretofore dele-

gated to the Board, it is hereby found and determined by the RFC Price Adjustment Board;

1. That \$55,000 of the profits realized by Contractor during its fiscal year ended December 31, 1942, under said Contract are excessive.

2. That in connection with the payment or discharge by any means of the amount of excessive profits hereby found and determined to have been realized by Contractor, Contractor shall be credited with the aggregate of the amounts, if any, to which said C. E. Bonnell and said Roy T. Earley may be entitled under Section 3806 of the Internal Revenue Code as computed by the Commissioner of Internal Revenue.

Accordingly, it is hereby ordered and directed that the excessive profits so found and determined, less the aggregate of any such tax credits, shall be eliminated by any one or more of the methods provided for in Section 403; and that the appropriate representatives of the Board shall take any and all action which may be necessary or desirable to effect such elimination.

RFC PRICE ADJUSTMENT
BOARD,

By: (Signed) G. B. COIT,
Vice Chairman.

Mar 17 1945

EXHIBIT C

(Copy)

RFC Price Adjustment Board

811 Vermont Avenue, N.W.

Washington 25, D. C.

Mar 17, 1945

Roy T. Earley and C. E. Bonnell

Trading as Bonnell Construction Company of
Bremerton

760½ Commerce Street

Tacoma, Washington

Gentlemen:

Enclosed is a signed copy, of even date herewith, of a Determination and Order entered in proceedings for the renegotiation of profits realized under Contract No. W869-ENG-6202 during your fiscal year ended December 31, 1942, pursuant to Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as last amended July 14, 1943, and as affected by Title VII of the Revenue Act of 1943.

You will observe, from an examination of such document, that this Board has determined that \$55,000 of profits realized by you during the fiscal year under review were excessive, and that under its terms you are ordered and directed to repay excessive profits in that amount less the aggregate of the amounts of the tax credits, if any, to which you may be entitled pursuant to Section 3806 of the Internal Revenue Code.

Demand is accordingly hereby made upon you for

payment of the amount due under the terms of the Order. Payment should be made in the form of a check or draft made payable to the order of "RFC Price Adjustment Board," and mailed to the Board, for the attention of the undersigned, 811 Vermont Avenue, Northwest, Washington 25, D.C. Interest at the rate of 6% per annum on the net amount due will become payable from and after a date fifteen days from the date of this letter of demand.

You should furnish us either with the originals or with certified copies of the communications from the Internal Revenue Agent in Charge, supporting the amount of the tax credits for which allowance is claimed in calculating the net amount due under the Order.

Very truly yours,
/s/ FACIUS W. DAVIS,

Enclosure

Treasurer.

Return Receipt
(Copy)

Received from the Postmaster the Registered or Insured Article, the original number of which appears on the face of this Card.

1. ROY T. EARLEY

(Signature of name of addressee)

C. E. BERNA (illegible)

2. C. E. BERNA (illegible)

(Signature of addressee's agent—Agent should enter addressee's name on line ONE above)

Date of delivery: March 22, 1945.

EXHIBIT D

BONNELL CONSTRUCTION COMPANY

Recoveries:

Department	Effective Date	Amount	Application	
			Interest	Principal
War	7/ 4/45	\$3,064.34	\$232.02	\$2,831.32
War	8/ 9/45	3,134.86	101.40	3,033.46
War	9/29/45	877.25	118.21	759.04

Interest Computations:

Balance		Accrual	Recovery	Interest Balance
\$19,965.41	4/24/45 to 7/ 4/45	\$ 233.02	\$233.02	—0—
17,134.09	7/ 4/45 to 8/ 9/45	101.40	101.40	—0—
14,100.63	8/ 9/45 to 9/29/45	118.21	118.21	—0—
13,341.59	9/29/45 to 8/ 1/47	1,471.60	—0—	\$1,471.60

Interest from 8/1/47 on \$13,341.59 amounts to \$2.1931 per day.

Received RFC Price Adjustment Board Aug. 22, 1947. Office of the Secretary.

[Endorsed] : Filed June 29, 1948.

[Title of District Court and Cause.]

MOTION TO STRIKE

Comes now C. E. Bonnell, d/b/a The Bonnell Construction Company, one of the defendants herein, and moves to strike the complaint herein for the reason and upon the ground that there is sought to be set out in said complaint separate alleged causes of action against the defendants founded upon a separate transaction and occurrence which are not stated in separate counts as required by Sub-division (b) Rule 10 of the Rules of Practice prescribed for the District Courts of the United States.

In the alternative, and in the event that the foregoing Motion be denied and without waiving said Motion, this defendant moves for an order of the Court striking each and every portion of said com-

plaint, including Exhibit D attached thereto, which refers to interest or the alleged liability of this defendant to the plaintiffs for interest.

/s/ L. L. THOMPSON,
HENDERSON, CARNAHAN &
THOMPSON,
Attorneys for defendant C. E.
Bonnell.

Copy received this 20th day of July, 1948.

/s/ J. CHARLES DENNIS,
U. S. Attorney.

[Endorsed]: Filed July 20, 1948.

[Title of District Court and Cause.]

MOTION TO DISMISS

Comes now C. E. Bonnell, d/b/a The Bonnell Construction Company, one of the defendants herein, and moves to dismiss this action for the reason and upon the ground that the complaint fails to state a claim against this defendant upon which relief can be granted.

/s/ L. L. THOMPSON,
HENDERSON, CARNAHAN &
THOMPSON,
Attorneys for defendant C. E.
Bonnell.

Copy received this 20th day of July, 1948.

/s/ J. CHARLES DENNIS,
U. S. Attorney.

[Endorsed]: Filed July 20, 1948.

[Title of District Court and Cause.]

MOTION TO DISMISS

Comes now Roy T. Earley, d.b.a The Roy T. Earley Company, one of the defendants herein, and moves to dismiss this action for the reason and upon the ground that the complaint fails to state a claim against this defendant upon which relief can be granted.

/s/ L. L. THOMPSON,

HENDERSON, CARNAHAN &
THOMPSON,

Attorneys for defendant Roy
T. Earley.

Copy received this 20th day of July, 1948.

/s/ J. CHARLES DENNIS,

U. S. Attorney.

[Endorsed]: Filed July 20, 1948.

[Title of District Court and Cause.]

MOTION TO STRIKE

Comes now Roy T. Earley, d/b/a The Roy T. Earley Company, one of the defendants herein, and moves to strike the complaint herein for the reason and upon the ground that there is sought to be set out in said complaint separate alleged causes of action against the defendants founded upon a separate transaction and occurrence which are not stated in separate counts as required by Sub-division (b)

Rule 10 of the Rules of Practice prescribed for the District Courts of the United States.

In the alternative, and in the event that the foregoing Motion be denied and without waiving said Motion, this defendant moves for an order of the Court striking each and every portion of said complaint, including Exhibit D attached thereto, which refers to interest or the alleged liability of this defendant to the plaintiffs for interest.

/s/ L. L. THOMPSON,

HENDERSON, CARNAHAN &
THOMPSON,

Attorneys for defendant Roy
T. Earley.

Copy received this 7/20/48.

/s/ J. CHARLES DENNIS,

U. S. Attorney.

[Endorsed]: Filed July 20, 1948.

[Title of District Court and Cause.]

ORDER

This matter coming on regularly for hearing on January 24, 1949, pursuant to notice, upon the separate motions of the defendants herein to strike the complaint upon the ground that alleged separate causes of action are not set forth in separate counts, and in the alternative, that all reference to liability for interest in the complaint and Exhibit

“D” attached thereto be stricken, and upon the separate motions of the defendants to dismiss the complaint on the ground that it fails to state a claim against the respective defendants upon which relief can be granted, and the defendants having served and filed their memorandum on Motion to Dismiss, Motion to Separately State, or in the Alternative to Strike, and the plaintiff having served and filed its memorandum and Reply Brief upon the points of law specified in defendant’s memorandum and motions, and the court having heard the arguments of L. L. Thompson, of counsel for defendants, in support of said motions, except the motion to separately state which counsel assertedly abandoned on behalf of defendants, and having heard the argument of Guy A. B. Dovell, Assistant United States Attorney, of counsel for plaintiffs, in opposition thereto, and the court having taken under advisement the question of constitutionality of the Renegotiation Act in its application to a Government executed contract as outlined in defendants’ memorandum and argument, and having on January 25, 1949, in open court rendered its decision overruling and denying said motions with exceptions allowed defendants, it is now, therefore,

Ordered that the defendants’ said motions to strike the complaint, or in the alternative to strike all reference to liability for interest be and the same are hereby overruled, and that defendants’ motions to dismiss the complaint be and the same are hereby in all respects denied.

To each of which rulings, except as to the motions to separately state, the defendants, by counsel, except and their exceptions are hereby allowed.

It is the further Order of the court that the defendants shall have thirty (30) days from the date of entry of this order within which to file and serve their answer to the complaint herein.

Done in Open Court this 27th day of Jan., 1949.

/s/ CHARLES H. LEAVEY,
U. S. District Judge.

Approved as to Form:

/s/ L. L. THOMPSON,
Of Counsel for Defendants.

Presented by:

/s/ GUY A. B. DOVELL,
Assistant U. S. Attorney.

[Endorsed]: Filed Jan. 27, 1949.

[Title of District Court and Cause.]

ANSWER

Come now the defendants and for answer to the complaint of the plaintiffs admit, deny and allege as follows:

I.

Defendants admit the allegations contained in paragraphs I and II of the complaint.

II.

Defendants admit the allegations contained in paragraph III of the complaint except that they deny:

1. That there was any agreement that said job would be performed under the trade name of Bonnell Construction Company.

2. That there was ever any agreement between these defendants by which the defendant Bonnell constituted the defendant Earley as his agent for all purposes of said War Department contract, or for any purpose.

III.

Answering the allegations contained in paragraph IV of the complaint, these defendants deny each and every allegation therein contained, except that they admit that the RFC Price Adjustment Board mailed to the defendant Bonnell a certain document which, in words and figures, was the same as Exhibit "B" attached to the complaint.

IV.

Answering the allegations contained in paragraph V of the complaint, these defendants admit that a letter which, in words and figures, was the same as Exhibit "C" attached to the complaint, was mailed to and received by the defendant C. E. Bonnell.

V.

Answering the allegations contained in paragraph VI of the complaint, these defendants admit that

in the event it should be adjudicated that the profits received by them under said contract were excessive in the sum of \$55,000.00, then there should be credited thereon a tax credit of \$35,034.59 as alleged in said paragraph.

VI.

Answering the allegations contained in paragraph VII of said complaint, these defendants deny each and every allegation therein contained, except that they admit:

1. That they have refused and still refuse to voluntarily pay to the plaintiffs any sums of money claimed by the plaintiffs to be due under said alleged renegotiation.

2. That they admit that the plaintiffs have heretofore withheld from the defendant Bonnell the sum of \$7,076.45, which represents moneys they would otherwise have paid to Bonnell upon other transactions between Bonnell and the plaintiffs.

The defendants further allege that in addition to the sum of \$7,076.45, the plaintiffs on April 6, 1948 withheld and wrongfully applied upon said renegotiation claim the sum of \$307.73, which sum represented an income tax refund allowed to the defendant Bonnell by the Bureau of Internal Revenue of the United States. Defendants also deny that there is due, owing and unpaid from these defendants to the plaintiffs the sum of \$13,341.59, with interest, or any sum whatsoever.

For a separate partial answer and defense to said complaint, insofar as the plaintiffs' claim for in-

terest is concerned, and without admitting that defendants are liable to the plaintiffs herein any sum, defendants allege:

I.

The contract entered into between defendant Bonnell and the plaintiffs, referred to in the complaint, was entered into shortly after the beginning of World War No. 2 and was for the immediate construction of certain military barracks in Bremerton. The defendant Bonnell made a lump sum contract with the plaintiffs for the construction of said barracks and secured the performance thereof by a security bond. Said contract provided that the work must be completed within sixty days and involved much hazard and risk of loss arising out of the then uncertainty with respect to securing materials and adequate labor. Defendant Earley had been for many years engaged in the contracting business and during the year 1942 he took contracts from the plaintiffs necessitated by the war in a substantial sum. Earley was renegotiated by the plaintiffs for all of his said contracts which were subject to renegotiation in said years and it was found and determined that he made no excessive profits and he was not required to repay to the Government any sum whatsoever upon said contracts. During said time it was almost the universal practice of the Government to renegotiate war contracts on an annual basis and this practice was made obligatory by Congress in the amendment made by Congress to the original Act in October, 1943. The

effect of the action taken by the plaintiffs in this case is to apply to the defendant Earley an inequitable and unjust rule not followed in the renegotiation of other war contracts on account of the fortuitous event that in this particular instance the defendant Earley had a joint venture arrangement with the defendant Bonnell.

II.

During said time also the ordinary commercial rate of interest in the community ranged from $3\frac{1}{2}\%$ to $4\frac{1}{2}\%$, even upon open and commercial unsecured loans. During the same period the Government paid interest upon loans made to it ranging from less than 1% on short-term loans to a maximum of 2.9% on Treasury Bond loans. The figure of 6% interest demanded by the Government was and is excessive and exorbitant, since during said period there were few, if any, loans of a legitimate business nature made at such an interest rate. In the case of *Arkansas Valley Railway vs. U. S.*, 68 Fed. Sup. 727, the Government contended in the Court of Claims of the United States in a suit brought against it on a claim for which the statute provided no rate of interest, that it ought not to exceed 4%, which rate of interest was fixed by the Court of Claims. Defendants allege that the Government, by reason of the position taken by it in said case before the Court of Claims, has established a maximum interest rate which should be charged, and that the charging of interest in excess of 4% would be in-

equitable and unjust and contrary to the position taken by the Government with respect to claims against it.

III.

On June 20, 1946 the attorneys for these defendants received a letter from Guy A. B. Dovell, Assistant United States Attorney in Tacoma, in which said attorneys were advised that the office of the District Attorney was "in receipt of instructions from the Attorney General of the United States to undertake settlement of the above matter." The matter referred to in the letter was the claim of the Government against these defendants herein involved. Thereafter, there was some discussion between defendants' attorneys and Mr. Dovell which culminated in the submission by defendants' counsel to Mr. Dovell on October 18, 1946 of an offer of compromise and settlement. Defendants allege on information and belief that said offer of compromise so made was forwarded by the office of the District Attorney to the Attorney General of the United States. Thereafter, the office of the Attorney General of the United States advised the District Attorney by a written communication as follows:

"In view of the circumstances of this case, it is suggested that you have the contractor's attorneys to make a formal written offer of compromise settlement addressed to The Attorney General. The offer should cover in full detail exactly what the contractor proposes to do. A copy of such proposal can be lodged

with you at the same time the original is mailed to the Department.”

Thereafter, and pursuant to said suggestion so made, these defendants on December 20, 1946 submitted to the Attorney General of the United States an offer of compromise and settlement. On January 13, 1947 one John F. Sonnett, Assistant Attorney General of the United States, and apparently in charge of this claim, sent to defendants’ attorneys a letter which, omitting salutation and signature, read as follows:

“This is to advise you that your letter of December 20, 1946 is being considered as a formal offer of compromise settlement in this case.

“As is customary in all compromise settlement cases the views of the Government agency in interest and the views of the United States Attorney handling the case will be sought before giving the offer final consideration in this Department. We are now awaiting the views of the United States Attorney at Seattle, Washington. As soon as we hear from him you will be advised of the Department’s final position on the matter.”

Defendants do not know what, if any, views were expressed by the United States Attorney at Seattle, Washington concerning defendants’ offer of compromise, but allege on information and belief that it was, to some extent at least, favorable. At this time several cases were pending in the Federal

Courts of the United States involving the validity of the Renegotiation Act. Defendants allege, on information and belief, that no action was taken on defendants' offer of compromise, pending the determination of certain cases then pending in the Federal Courts. In any event, Mr. Sonnett did not advise defendants' counsel at any time or place "of the Department's final position on the matter," as promised in his letter of January 13, 1947. Neither defendants or their counsel have ever received any direct advice from the office of the Attorney General with respect to the position of that office from that date. However, on or about the 1st day of June, 1948 defendants' attorneys were advised by Mr. Dovell that the office of the Attorney General of the United States had finally decided to reject the previous compromise proposal made by the defendants on December 20, 1946. The delay in the final determination of this matter, therefore, was in part, at least, caused by the action of the office of the Attorney General of the United States in holding under consideration defendants' offer of compromise for a period of almost one and one-half years, and that it is therefore inequitable to charge and assess interest at the rate of 6% per annum against the defendants during that period, since no complaint had been filed by the plaintiffs and the question of the liability of the defendants, in view of the fact that the contract had been entered into before the date of the passage of the Renegotiation Act, was at least doubtful.

Wherefore, defendants pray judgment as follows:

1. That this action be dismissed with prejudice.

2. In the alternative, and in the event that the court shall refuse to dismiss the action and shall allow a recovery of the face of the plaintiffs' claim, then that the defendants be permitted to introduce evidence concerning the interest rate to be applied.

/s/ L. L. THOMPSON,
HENDERSON, CARNAHAN &
THOMPSON,
Attorneys for Defendants.

Received copy Feb. 10, 1949.

/s/ GUY A. B. DOVELL,
Assistant U. S. Attorney.

[Endorsed]: Filed Feb. 10, 1949.

[Title of District Court and Cause.]

MOTION FOR JUDGMENT ON PLEADINGS

Comes now the plaintiffs in the above-entitled action by their attorneys, J. Charles Dennis, United States Attorney, and Guy A. B. Dovell, Assistant United States Attorney, and respectfully move the court to enter judgment on the pleadings filed in this case, in favor of the plaintiffs and against the defendants, and assign therefor the following reasons and grounds.

I.

That on or about April 24, 1942 defendant C. E. Bonnell, d/b/a The Bonnell Construction Company entered into a war contract with plaintiffs, which was subject to renegotiation, and thereafter in order to perform said contract entered into a joint adventure agreement with defendant Roy T. Earley, d/b/a The Roy T. Earley Company, whereby it was agreed they should share in the performance of said contract and equally in the profits therefrom, and as such they performed said contract.

II.

That the RFC Price Adjustment Board, in compliance with law and pursuant to duly delegated authority has determined that \$55,000.00 of the profits realized by the defendants during the fiscal year ending December 31, 1942, under said contract, are excessive, and for which they are liable to plaintiffs.

III.

That plaintiffs are suing to recover the sum of \$13,341.59, being the net amount of said obligation remaining after the application in reduction of said obligation of tax credits in the sum of \$35,034.59, and the sum of \$7,076.45 out of funds which have at various times come due to the defendants, and have been applied either to payment of interest which theretofore had accrued or to reduction of principal obligation.

IV.

That the correctness of the amount claimed as excessive and the defenses pertaining thereto are in the exclusive jurisdiction of the Tax Court of the United States; and the issues of law entertainable in this court and heretofore raised by the defendants pursuant to their motions herein filed, have been determined by this court in favor of the plaintiffs.

V.

That defendants are indebted to plaintiffs in the sum of \$13,341.59, and interest from September 29, 1945, as pleaded, at such rate of interest as the court may determine to be proper.

VI.

That Rule 12(c) of the Federal Rules of Civil Procedure, as amended, with reference to motion for judgment on the pleadings, provides:

“After the pleadings are closed, but within such time as not to delay the trial, any party may move for judgment on the pleadings. If, on a motion for judgment on the pleadings, matters outside the pleadings are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all materials made pertinent to such a motion by Rule 56.”

VII.

That in support of the position that the matter of interest and the rate thereof applicable to the obligation herein involved is a question of law, the plaintiffs herewith submit their memorandum.

/s/ J. CHARLES DENNIS,

U. S. Attorney.

/s/ GUY A. B. DOVELL,

Assistant U. S. Attorney.

Received copy of above Motion this 22nd day of April, 1949.

/s/ L. L. THOMPSON,

Attorney for Defendants.

[Endorsed]: April 22, 1949.

[Title of District Court and Cause.]

TRANSCRIPT OF PROCEEDINGS

25th day of January, 1949

Before: The Honorable Charles H. Leavy, United States District Judge, at Tacoma, Washington.

APPEARANCES:

GUY A. B. DOVELL,

Assistant United States Attorney, appeared for the Plaintiffs; and

L. L. THOMPSON,

of Henderson, Carnahan and Thompson, 1410-24 Puget Sound Bank Building, Tacoma, Washington, appeared for the Defendants.

The Court: Now we will refer to Docket 1146, United States, et al, vs. C. E. Bonnell, doing business as Bonnell Construction, et al, for final disposition.

I have asked counsel back into Court again in connection with this matter because since it was presented by oral argument yesterday I have checked the authorities that are relied upon and gone into the matter much more fully and unless there be a stipulation—I would want that to be formal—I do not feel that I could make a disposition of the case on its merits.

I think there ought to be, for the purpose of a complete record, an Answer filed herein, and that is the matter that I want to take up, Mr. Thompson, if you are agreeable to that.

Mr. Thompson: No; I am not consenting that the Court make a disposition on the merits because I take it that, if we are going to appeal it, I don't want to do it on this record. I would want to file an Answer.

The Court: You couldn't have an order denying your motion to dismiss because it wouldn't be an appealable order.

Mr. Thompson: I won't stipulate.

The Court: I am not going to ask you to.

There are two or three motions here. There is a motion to state separately and a motion to dismiss.

Mr. Dovell: The motion, I think, is to state separately and then also in the alternative to strike the interest and then there is another motion to dismiss,

as I recall. But, the motion to state separately was abandoned.

The Court: Yes, but in order to complete the record the Court will overrule that motion and allow an exception. And the motion to strike interest will likewise be overruled. And, the motion to dismiss will have to be denied. And an exception will be allowed to each ruling and a formal order made and the Defendant will be allowed such reasonable time as is needed to file an Answer.

Mr. Thompson: I would like more than ten days. I would like at least thirty days, because my client went back to Boston.

The Court: You want additional time, Mr. Thompson?

Mr. Thompson: I would want additional time. I think the *modus operandi* would be to put an Answer in if I want to appeal. I wouldn't want to do that on just the Government's bill of complaint.

The Court: How much time do you want?

Mr. Thompson: I would like to make it thirty days.

The Court: Do you have any objection?

Mr. Dovell: No, your Honor, but there is one point that I would like to have covered and that is counsel's oral motion to dismiss Defendant Earley that was made yesterday.

Mr. Thompson: That wasn't oral. I interposed——

The Court: They are separate motions.

Mr. Dovell: Yes, your Honor.

The Court: The motion will be denied and the Defendant's will have thirty days in which to plead further in this matter. You may prepare a formal order, Mr. Thompson, and an exception will be allowed the Defendants.

Mr. Dovell: Yes, your Honor.

The Court: Now, if there is nothing further, Court will be adjourned.

(Whereupon, at 2:50 o'clock, p.m., January 25, 1949, the hearing in this cause was adjourned.)

CERTIFICATE

I, Earl V. Halvorson, official court reporter for the above-entitled court, hereby certify that the foregoing is a true and correct transcript of the matters therein set out.

/s/ EARL V. HALVORSON.

[Endorsed]: Filed April 29, 1949.

[Title of District Court and Cause.]

TRANSCRIPT OF COURT'S ORAL DECISION

Given by the Honorable Charles H. Leavy, United States District Judge, in the above-entitled and numbered cause, in the above-entitled court, on the 2nd day of May, 1949, at Tacoma, Washington.

Argument by respective counsel having been made, the following proceedings were had:

The Court: Mr. Dovell, I am satisfied that interest should be allowed here on the amount of the claim less the amount you conceded that should be deducted, but what I would like to have you talk on is what the rate should be.

(Whereupon, further argument was made by counsel for Plaintiff.)

The Court: It is your contention that it should be six per cent and no less than that?

Mr. Dovell: It ought to be six per cent but my contention is that it is within the discretion of the Court.

The Court: Motion by the Plaintiff, in the form of a motion for a judgment on the pleadings, is granted less the amount admitted to be a credit to the Defendant.

That leaves us only the question of what, if any, interest should be allowed on that sum. I agree with counsel on both sides that the matter of determining interest is one that is within the discretion of the Court since the Act is silent in regard to interest.

If it be within the discretion of the Court, then it follows on the equitable side of the law to determine what would be equitable and who is the more to blame if this claim hasn't heretofore been cleared. It is almost four years now, I believe. While the amount is not an unusually large one, nevertheless the interest item becomes quite large, possibly it could be about twenty per cent of the

total amount. The Government agrees it is at least as culpable as the Defendant in this case.

Mr. Dovell: I might say, your Honor, that it never discouraged the Defendant from making further offers.

Mr. Thompson: It is not the District Attorney. I want to absolve the District Attorney of anything.

The Court: I don't think you can blame the District Attorney.

Mr. Thompson: No.

The Court: But the authorities in Washington ought to give precedence to those cases that have reached the Courts and give priority to them so that they can make a disposition of them, even though I appreciate they have a tremendous responsibility. The Defendant at the outset would have had to pay about four per cent for money borrowed; the Government had it gotten their money at the outset would have saved themselves paying 2.9 per cent on the sum. Consequently, I think the interest should be fixed somewhere between those figures and I shall find that the interest in this particular case, under the facts as admitted by the oral arguments and by the pleadings, should be at the rate of three (3) per cent instead of six (6); and you may prepare a judgment and make a disposition.

Mr. Dovell: Exception, your Honor.

The Court: And you will be allowed an exception if you desire one.

Now, if there is nothing further, Court will be adjourned.

(Whereupon, further hearing in this cause was concluded.)

CERTIFICATE

I, Earl V. Halvorson, official court reporter for the within-described court, hereby certify that the foregoing is a true and complete transcript of the matters therein set out.

/s/ EARL V. HALVORSON.

[Endorsed]: Filed May 17, 1949.

United States District Court, Western District of
Washington, Southern Division
No. 1146

UNITED STATES OF AMERICA, et al,
Plaintiffs,

vs.

C. E. BONNELL, d/b/a THE BONNEL CON-
STRUCTION COMPANY, and ROY T.
EARLEY, d/b/a THE ROY T. EARLEY
COMPANY, Joint Adventurers under the trade
name "BONNELL CONSTRUCTION COM-
PANY OF BREMERTON,"

Defendants.

JUDGMENT

This cause coming on to be heard on May 2, 1949, on plaintiff's motion for judgment on the pleadings, the plaintiff appearing by J. Charles Dennis, United

States Attorney and Guy A. B. Dovell, Assistant United States Attorney, and defendants appearing by L. L. Thompson of counsel, Henderson, Carnahan & Thompson, attorneys for defendants, and it appearing to the court that said motion is based upon the grounds that the defendant, C. E. Bonnell, d/b/a The Bonnell Construction Company, on or about April 24, 1942, entered into a war contract with plaintiffs, which was subject to renegotiation, and thereafter in order to perform said contract entered into joint adventure agreement with defendant Roy T. Earley, d/b/a The Roy T. Earley Company, whereby it was agreed between them they should share in the performance of said contract, and equally in the profits therefrom and as such they performed said contract; that the R. F. C. Price Adjustment Board, in compliance with law, and pursuant to duly delegated authority has determined that \$55,000.00 of the profits realized by the defendants during the fiscal year ending December 31, 1942, under said contract are excessive, and for which the defendants are liable to the plaintiffs, and on March 17, 1945, made demand for payment; that the plaintiffs are suing to recover the sum of \$13,341.59 with interest at the rate of 6% per annum from September 29, 1945, as pleaded, being the net amount of said obligation resulting from the application in reduction thereof of tax credits in the sum of \$35,034.59, and the sum of \$7,076.45 out of funds which have at various times come due to the defendants and have been applied to the pay-

ment of accrued interest and the remainder on the principal, as shown by Exhibit "D" to the complaint; that the issues of law raised by defendant's Motions to Strike the claim of interest liability from the complaint, and motions to dismiss the action involving the constitutionality of the Renegotiation Act in its application to the contract herein made with the government previous to the passage of the Act, have heretofore been determined by the court; and it further appearing to the court that the defendants by their failure to make application to the Tax Court cannot now question the correctness of the amount claimed as excessive and the defenses pertaining thereto, including the defense set up in the answer that defendant Earley was unjustly renegotiated on his joint-adventure contract separate from all his other contracts for that year, are not now available to them or either of them; and the court having heard the arguments of counsel upon the question of liability for interest on the contract entered into prior to the Renegotiation Act and upon the question of rate of interest applicable to the renegotiated claim, and it appearing to the court that the plaintiffs are entitled to judgment on the pleadings on the admitted facts therein appearing and as a matter of law, and that interest at the rate of 3% per annum should be allowed on said claim, and that the payments in the sum of \$7,076.45 heretofore applied to interest and principal should be adjusted according to said rate, and a further tax refund of \$307.73, should be allowed

as of April 6, 1948, and that judgment should be rendered the plaintiffs for the principal balance in the sum of \$12,806.54, and for the amount of interest accrued from date of last credit of interest, September 29, 1945, to the date of said principal credit, April 6, 1948, in the sum of \$991.66, and together with interest thereafter at said rate on the sum of \$12,806.54 to June 1, 1949, the date of entry hereof, in the sum of \$442.09, amounting to the total sum, principal and interest of \$14,240.29, and for the plaintiff's costs herein incurred; and the court being fully advised in the premises; now, therefore, it is hereby,

Ordered, Adjudged and Decreed that the motion of the plaintiffs for judgment upon the pleadings be and the same hereby, in conformity with the law and admitted facts, is granted; and that it is, therefore,

Ordered, Adjudged and Decreed, that the plaintiff, United States of America, do have and recover of the defendants, C. E. Bonnell and Roy T. Earley, and each of them, judgment in the sum of \$14,240.29, and for plaintiff's costs, as taxed herein, to-wit, the sum of \$39.00.

Each of said parties, by counsel, has excepted to each and every adverse ruling of the court hereinabove set forth and said exception is hereby allowed.

Done In Open Court this 1st day of June, 1949.

/s/ CHARLES H. LEAVY,

U. S. District Judge.

Presented by:

/s/ GUY A. B. DOVELL,

Assistant U. S. Attorney.

Receipt of copy of above proposed form of judgment acknowledged this 9th day of May, 1949.

/s/ L. L. THOMPSON,

Attorney for Defendants.

Notice of entry waived.

/s/ L. L. THOMPSON.

EXHIBIT "D" TO COMPLAINT

Adjusted pursuant to court's ruling of 3% interest in lieu of 6% per annum.

Recoveries Department	Effective Date	Amount	Interest	Application Principal
War	7/ 4/45	\$3,064.34	\$116.51	\$ 2,947.83
War	8/ 9/45	3,134.86	50.40	3,084.46
War	9/29/45	877.25	58.40	818.85

(Tax Refund \$307.73 as of 4/6/48—See

Answer not included in above application.)

Interest Computations:

Balance		(3%) Accrual	Recovery	Interest Balance
\$19,965.41	4/24/45 to 7/24/45	\$ 116.51	\$116.51	\$ —0—
17,017.58	7/ 4/45 to 8/ 9/45	50.40	50.40	—0—
13,933.12	8/ 9/45 to 9/29/45	58.40	58.40	—0—
13,114.12	9/29/45 to 4/ 6/48	991.66	-----	991.66
12,806.54	4/ 6/48 to 6/ 1/49	442.09	-----	442.09
Total Interest Balance.....				\$ 1,433.75
Forward Principal Balance.....				12,806.54
Total				\$14,240.29

[Endorsed] : Filed June 1, 1949.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that the United States of America, plaintiff above named, hereby appeals to the Court of Appeals for the Ninth Circuit from that part of the District Court's order set forth in the minutes of proceedings entered upon the court journal at the time of hearing plaintiff's motion for judgment on the pleadings on May 2, 1949 and from so much of the final judgment pursuant to said order entered in this action on June 1, 1949 as denies to the plaintiff from the defendants a recovery upon its claim in the full sum of \$13,341.59, as principal balance due, with interest thereon at the rate of 6% per annum from September 29, 1945, less a withheld tax refund of \$307.73 as deductible from the amount of said interest.

Dated this 27th day of June, 1949.

/s/ J. CHARLES DENNIS,

U. S. Attorney.

/s/ GUY A. B. DOVELL,

Assistant U. S. Attorney,

Attorneys for Appellant.

Received copy of above Notice of Appeal this 27th day of June, 1949.

/s/ L. L. THOMPSON,

Attorney for Defendants.

Copy of the within Notice of Appeals mailed to Henderson, Carnahan & Thompson, attorneys for

defendants, Tacoma, Washington, this 27th day of June, 1949.

/s/ E. E. REDMAYNE,
Deputy Clerk.

[Endorsed) Filed June 27, 1949.

[Title of District Court and Cause.]

PLAINTIFF'S DESIGNATION OF CONTENTS
OF RECORD ON APPEAL

To the Clerk of the above entitled court:

The plaintiff, United States of America, herewith designates the following portions of the record and proceedings to be contained in the record on appeal:

1. Complaint
2. Answer
3. Motion for Judgment on Pleadings
4. Clerk's Minute entry covering order of court
May 2, 1949
5. Judgment entered June 1, 1949
6. Notice of Appeal
7. Statement of points and acceptance of service
endorsed thereon.
8. This Designation and acceptance of service
endorsed thereon.

Dated this 27th day of June, 1949.

/s/ J. CHARLES DENNIS,
U. S. Attorney.

/s/ GUY A. B. DOVELL,
Assistant U. S. Attorney.

Received a copy of the within designation this 27th day of June, 1949.

/s/ L. L. THOMPSON,
Attorney for Defendants.

[Endorsed]: Filed June 27, 1949.

[Title of District Court and Cause.]

STATEMENT OF POINTS

The following is a statement of points on which appellant intends to rely on appeal:

I.

That the court erred in determining that 3% per annum is a proper rate of interest to be allowed plaintiff on its claim involved in this action, instituted June 29, 1948, to collect excessive profits, less credits owed by defendants pursuant to unilateral determination, under the Renegotiation Act, that defendants realized excessive profits on a war contract during the fiscal year ending December 31, 1942.

II.

That the court erred in fixing the rate of interest to be allowed on plaintiff's claim herein on the basis of what rate of interest the government would have paid for the use of equivalent funds pending payment of said claim, as a proper measure of damages

suffered by the plaintiff because of defendant's failure to make payment.

III.

That appellant (plaintiff) is entitled to interest at the rate of 6% per annum upon the amount determined as excessive profits to be eliminated less tax credits and tax refund as set out in the pleadings herein, from and after the date fixed in the demand for payment.

IV.

That appellant (plaintiff) is entitled to recover judgment in the sum of \$13,341.59 principal balance due on its claim, plus interest thereon at the rate of 6% per annum from September 29, 1945, as prayed for in its complaint, less a withheld tax refund of \$307.73 of April 6, 1948, as deductible from the amount of said interest, making a total as of June 1, 1949 principal and interest in the sum of \$15,974.84.

Dated this 27th day of June, 1949.

/s/ J. CHARLES DENNIS,

U. S. Attorney.

/s/ GUY A. B. DOVELL,

Assistant U. S. Attorney.

Received a copy of the foregoing statement this 27th day of June, 1949.

/s/ L. L. THOMPSON,

Attorney for Defendants.

[Endorsed]: Filed June 27, 1949.

[Title of District Court and Cause.]

DEFENDANTS' DESIGNATION OF ADDI-
TIONAL CONTENTS OF RECORD ON
APPEAL

To the Clerk of the above entitled court:

The defendants herein herewith designate the following portions of the record and proceedings to be contained in the record on appeal in addition to those heretofore designated by the plaintiff.

1. Defendants' Motion to Dismiss the action.
2. Order of the Court denying said Motion.
3. This Designation and acceptance of service endorsed thereon.

Dated this 7th day of July, 1949.

/s/ L. L. THOMPSON,

Attorney for Defendants.

Received a copy of the within Designation this
7th day of July, 1949.

/s/ J. CHARLES DENNIS,

/s/ GUY A. B. DOVELL,

Attorneys for Plaintiff.

[Endorsed]: Filed July 7, 1949.

[Title of District Court and Cause.]

STIPULATION DESIGNATING PARTS OF
RECORD TO BE OMITTED FROM THE
RECORD ON APPEAL

Pursuant to Rule 75(o) of the Federal Rules of Civil Procedure for the District Courts of the United States, and the provision for hearing of appeals on original papers by Rule 11 of the United States Circuit Court of Appeals for the Ninth Circuit, effective January 1, 1949, it is hereby,

Stipulated and Agreed and understood by and between J. Charles Dennis, United States Attorney and Guy A. B. Dovell, Assistant United States Attorney, attorneys of record herein for plaintiffs, and L. L. Thompson of counsel for defendants, that all the original papers of record in the above entitled court and cause are to be transmitted by the clerk of the District Court to the United States Court of Appeals for the Ninth Circuit, with the exception of the following named, which the parties hereto by counsel, have agreed shall be omitted, to-wit:

Omissions from Record on Appeal

1. Summons
2. Plaintiff's Memorandum filed 1/14/49
3. Notice of Hearing of Motions filed January 14, 1949
4. Defendant's Memorandum filed January 21, 1949
5. Plaintiff's Reply Brief filed January 24, 1949
6. Plaintiff's Memorandum filed April 22, 1949

7. Notice of Hearing filed April 22, 1949
8. Defendant's Memorandum filed April 29, 1949
9. Cost Bill

Dated this 8th day of July, 1949.

/s/ J. CHARLES DENNIS,

U. S. Attorney.

/s/ GUY A. B. DOVELL,

Assistant U. S. Attorney.

/s/ L. L. THOMPSON,

of Counsel for Defendants.

[Endorsed]: Filed July 8, 1949.

[Title of District Court and Cause.]

CLERK'S CERTIFICATE TO RECORD ON
APPEAL

I, Millard P. Thomas, Clerk of the United States District Court for the Western District of Washington, do hereby certify that pursuant to the provisions of Subdivision 1 of Rule 11, as amended, of the United States Court of Appeals for the Ninth Circuit and Rule 75(o) of the Federal Rules of Civil Procedure, as amended, I am transmitting herewith as the Record on Appeal in the above-entitled cause all of the original pleadings on file and of record in said cause in my office at Tacoma, Washington (except those omitted pursuant to stipulation of the parties), as set forth below:

1. Complaint (1)

2. Motion to Dismiss (3)
3. Motion to Strike (4)
4. Motion to Dismiss (5)
5. Motion to Strike (6)
6. Order (10)
7. Answer (11)
8. Motion for Judgment on Pleadings (12)
9. Reporter's Transcript of Proceedings (16)
10. Reporter's Transcript of Court's Oral Decision (17)
11. Judgment (18)
12. Notice of Appeal (20)
13. Plaintiff's Designation of Contents of Record on Appeal (21)
14. Statement of Points (22)
15. Defendants' Designation of Additional Contents of Record on Appeal (23)
16. Stipulation Designating Parts of Record to be Omitted from the Record on Appeal (24)

In Witness Whereof I have hereunto set my hand and affixed the seal of said Court, in the City of Tacoma, in the Western District of Washington, this 22nd day of July, 1949.

MILLARD P. THOMAS,
Clerk.

[Seal] By /s/ E. E. REDMAYNE,
Deputy.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that C. E. Bonnell, doing business as Bonnell Construction Company, and Roy T. Earley, doing business as Roy T. Earley Company, defendants above named, do hereby appeal to the United States Court of Appeals of the Ninth Circuit from that certain final judgment entered by the above-entitled court on June 1, 1949, wherein and whereby judgment was entered in favor of the plaintiff United States of America, and against the defendants herein in the sum of \$14,-240.29 and plaintiffs costs.

Dated this 29th day of July, 1949.

/s/ L. L. THOMPSON,
HENDERSON, CARNAHAN,
THOMPSON,
Attorneys for Defendants.

Copy received July 29, 1949.

/s/ HARRY SAGER,
Asst. U. S. Atty.

Copy of the within Notice of Appeal delivered to the United States Attorney, Tacoma, Washington, this 29th day of July, 1949.

/s/ E. E. REDMAYNE,
Deputy Clerk.

[Endorsed]: Filed July 29, 1949.

[Title of District Court and Cause.]

BOND FOR COSTS ON APPEAL

Know All Men by These Presents:

That we, C. E. Bonnell and Roy T. Earley, the defendants above named, as Principals, and the General Casualty Company of America, a corporation organized under the laws of the State of Washington, and authorized to transact the business of surety in the State of Washington, as Surety, are held and firmly bound unto United States of America, and John D. Goodloe, Henry T. Bodman, Harvey J. Gunderson, Harry Hise and Henry A. Mulligan, Directors of the Reconstruction Finance Corporation, the plaintiffs above named in the just and full sum of Two Hundred and Fifty (\$250.00) Dollars, for which sum, well and truly to be paid, we bind ourselves, our heirs, executors, administrators heirs, executors, administrators and successors, jointly and severally, firmly by these presents.

Sealed with our seals and dated this 29th day of July, 1949.

The Condition of This Obligation Is Such, That, Whereas, the above named plaintiff, United States of America, on the first day of June, A.D. 1949, in the above-entitled action and court, recovered judgment against the defendants above named for the sum of \$14,240.29.

And Whereas, the above-named principals have heretofore given due and proper notice that they appeal from said decision and judgment of said District Court to the United States Circuit Court of Appeals for the Ninth Circuit.

Now Therefore, if the said Principals, C. E. Bonnell and Roy T. Earley, shall pay to United States of America, and John D. Goodloe, Henry T. Bodman, Harvey J. Gunderson, Harry Hise and Henry A. Mulligan, Directors of the Reconstruction Finance Corporation, the plaintiffs above named, all costs and damages that may be awarded against said defendants, if the appeal is dismissed or the judgment affirmed, or such costs as the said Circuit Court of Appeals may award if the said judgment is modified, not exceeding the sum of \$250.00, then this obligation to be void, otherwise to remain in full force and effect.

[Seal] /s/ C. E. BONNELL,

[Seal] /s/ ROY T. EARLEY,

GENERAL CASUALTY COM-
PANY OF AMERICA.

By /s/ A. B. COMFORT,
Attorney in Fact.

Approved this day of July, 1949.

.....,

District Judge.

[Endorsed]: Filed July 29, 1949.

[Title of District Court and Cause.]

STATEMENT OF POINTS

The following is a statement of points on which the defendants, appellants on their appeal and ap-

pellees on the appeal of the plaintiff, intend to rely on their appeal:

I.

That the Court erred in overruling their motion to dismiss and in failing to hold that the Renegotiation Act was in violation of the Constitution of the United States insofar as it attempted to make subject to renegotiation a contract entered into by these appellants with the United States prior to the taking effect of the Renegotiation Act.

II.

That the Court erred in any event in allowing the plaintiff any interest whatsoever on its said claim for the reason that at the time the contract sought to be renegotiated was entered into there was no provision of law which authorized any such renegotiation and the Renegotiation Act which was subsequently passed contained no provision for the payment of interest. In other words, the point to be relied on is that, assuming the general constitutionality of the Act and assuming that the Court could properly hold that as to contracts entered into after the taking effect of the Act the right to renegotiate upon the part of the Government would be considered a part of the contract and therefore would support a judgment for interest, even without such a provision in the Statute, but that nevertheless this would not support a judgment for interest on a contract made previous to the taking effect of the Act in the absence of Statute.

III.

That the judgment should be reversed and the action ordered dismissed, or, in the alternative and in any event, that the judgment should be vacated and no judgment for interest should be added.

Dated this 29th day of July, 1949.

/s/ L. L. THOMPSON,
HENDERSON, CARNAHAN,
THOMPSON,
Attorneys for Defendants.

Received copy of the within Statement of Points this 29th day of July, 1949.

/s/ J. CHARLES DENNIS,
U. S. Atty.

/s/ HARRY SAGER,
Attorneys for Defendants.

[Endorsed]: Filed July 29, 1949.

[Title of District Court and Cause.]

CLERK'S CERTIFICATE

I, Millard P. Thomas, Clerk of the United States District Court for the Western District of Washington, do hereby certify that pursuant to the provisions of Subdiv. 1 of Rule 11, as amended, of the United States Court of Appeals' for the Ninth Circuit and Rule 70(o) of the Federal Rules of Civil Procedure, as amended, I am transmitting herewith as Additional Record on Appeal in the above-

entitled cause additional original pleadings on file and of record in said cause in my office at Tacoma, Washington, as requested by Defendants' Designation of the Contents of Record on Appeal to wit:

1. Notice (of defendants') of Appeal (25)
2. Cost Bond on Appeal (26)
3. Statement of Points, etc. (27)
4. Defendants' Designation of Contents of Record on Appeal (28).

In Witness Whereof I have hereunto set my hand and affixed the seal of said Court, in the City of Tacoma, in the Western District of Washington, this 30th day of July, 1949.

[Seal] MILLARD P. THOMAS,
Clerk.

By /s/ E. E. REDMAYNE,
Deputy.

[Endorsed]: No. 12306. United States Court of Appeals for the Ninth Circuit. United States of America, Appellant, vs. C. E. Bonnell, Doing Business as The Bonnell Construction Company, and Roy T. Earley, Doing Business as The Roy T. Earley Company, Joint Adventurers Under the Trade Name of Bonnell Construction Company of Bremerton, Appellee, and C. E. Bonnell, d/b/a The Bonnell Construction Company, and Roy T. Earley, d/b/a Roy T. Earley Company, etc., Appellants, vs. United States of America, Appellee. Transcript of Record. Appeals from the United States District

Court for the Western District of Washington,
Southern Division. Filed July 29, 1949.

PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for
the Ninth Circuit.

United States Court of Appeals for the
Ninth Circuit
No. 12306

UNITED STATES OF AMERICA,
Appellant,
vs.

C. E. BONNELL, d/b/a THE BONNELL CON-
STRUCTION COMPANY, and ROY T.
EARLEY, d/b/a THE ROY T. EARLEY
COMPANY, Joint Adventurers Under the
Trade Name "BONNELL CONSTRUCTION
COMPANY OF BREMERTON,"
Appellees.

APPELLANT'S STATEMENT OF POINTS
AND DESIGNATION OF RECORD FOR
PRINTING

Comes now appellant, United States of America,
and pursuant to subdivision 6, Rule 19 of the Rules
of the United States Court of Appeals for the Ninth
Circuit, states that the following is a re-statement of
the points upon which appellant intends to rely on
appeal, to wit:

I.

That the District Court erred in determining that 3% per annum is a proper rate of interest to be allowed plaintiff (appellant) on its claim involved in this action, instituted June 29, 1948, to collect excessive profits, less credits, owed by defendants pursuant to unilateral determination, under the Renegotiation Act, that defendants realized excessive profits on a war contract during the fiscal year ending December 31, 1942.

II.

That the District Court erred in fixing the rate of interest to be allowed on plaintiff's (appellant) claim herein on the basis of what rate of interest the government would have paid for the use of equivalent funds pending payment of said claim, as a fair and just compensation for defendants' failure and refusal to make payment upon demand.

III.

That appellant is entitled to interest at the rate of 6% per annum upon the amount determined as excessive profits to be eliminated less tax credits and tax refund as set out in the pleadings contained in the record herein, from and after the date fixed in the demand for payment.

IV.

That appellant is entitled to recover judgment in the sum of \$13,341.59, as principal balance due on its claim, plus interest thereon at the rate of

6% per annum from September 29, 1945, as prayed for in its complaint, less a withheld tax refund of \$307.73 of April 6, 1948, as deductible from the amount of said interest, making a total as of June 1, 1949, the date of entry of judgment, in the sum of \$15,974.84 principal and interest at said rate.

With the foregoing statement, the appellant designates as necessary for the consideration of this appeal all that portion of the original papers of record in this cause heretofore transmitted by the clerk of the District Court to the United States Court of Appeals for the Ninth Circuit in this cause, pursuant to stipulation of parties covering omissions from record on appeal, and the contents of which transmitted portion are as follows:

1. Complaint
2. Motion to Dismiss (Bonnell's)
3. Motion to Strike (Bonnell's)
4. Motion to Dismiss (Earley's)
5. Motion to Strike (Earley's)
6. Order on Motions.
7. Answer.
8. Motion for Judgment on Pleadings
9. Transcript of Proceedings on 1/25/49.
10. Transcript of Proceedings on 5/2/49.
11. Judgment (with recalculation of Exhibit "D" to complaint to reflect court's decision).
12. Notice of Appeal (plaintiff's)
13. Plaintiff's Designation of Contents.
14. Plaintiff's Statement of Points.
15. Defendants' Designation of Additional Contents.

16. Stipulation of omissions from record on appeal.

Dated this 5th day of August, 1949.

/s/ J. CHARLES DENNIS,

United States Attorney.

/s/ GUY A. B. DOVELL,

Assistant United States Attorney, Attorneys for Appellant.

Service of the foregoing, by receipt of true copy thereof, is hereby acknowledged this 5th day of August, 1949.

HENDERSON, CARNAHAN &
THOMPSON,

[Endorsed]: Filed Aug. 8, 1949.

I.

[Title of U. S. Court of Appeals and Cause.]

DESIGNATION OF ADDITIONAL PORTIONS
OF RECORD FOR PRINTING ON CROSS-
APPEAL OF APPELLEES

Come now C. E. Bonnell and Roy T. Earley, appellees on the appeal of the United States of America, and appellants on their cross-appeal, and designate the following portions of the record to be printed in addition to the portions heretofore designated by the United States of America, to wit:

1. Notice of Appeal by Bonnell and Earley from Judgment.
2. Cost Bond filed by them on such appeal.

3. Statement of points involved.

Dated this 8th day of August, 1949.

/s/ L. L. THOMPSON,
HENDERSON, CARNAHAN,
THOMPSON,

Attorneys for C. E. Bonnell and Roy T. Earley,
Appellees on Appeal of United States of Amer-
ica and Appellants on Their Cross-Appeal.

Receipt acknowledged this 8th day of August,
1949.

/s/ GUY A. B. DOVELL,
Asst. U. S. Atty.

[Endorsed]: Filed Aug. 10, 1949.

United States Court of Appeals for the
Ninth Circuit

No. 12306

UNITED STATES OF AMERICA,

Appellant and Appelle on Cross-Appeal,

vs.

C. E. BONNELL, d/b/a THE BONNELL CON-
STRUCTION COMPANY, and ROY T. EAR-
LEY, d/b/a THE ROY T. EARLEY COM-
PANY, Joint Adventurers Under the Trade
Name "BONNELL CONSTRUCTION COM-
PANY OF BREMERTON,"

Appellees and Appellants on Cross-Appeal.

STATEMENT OF POINTS TO BE RELIED
UPON BY APPELLANTS ON CROSS-
APPEAL

Come now C. E. Bonnell and Roy T. Earley, ap-
pellees on the appeal of the United States of Amer-
ica, plaintiff in the court below and appellants on
a separate or cross-appeal taken by them, and state
that the points upon which they intend to rely in
this court in this case are as follows:

1. That the court below erred in holding that the
provisions of the Federal Renegotiation Act as
amended (56 Statutes 245, Chapt. 247; 56 Statutes
982, Chapt. 247), insofar as they sought to author-
ize certain designated executive departments of the
Government to renegotiate the amount due from

the Government under prime contracts entered into by contractors with the Government, prior to April 28, 1942, the date the Act took effect, was not in violation of the Constitution of the United States, particularly the Fifth Amendment thereto. Appellants will rely particularly on *Lynch vs. U. S.*, 292 U. S. 571, and *Perry vs. U. S.*, 294 U. S. 330 in support of this point.

2. In the alternative and in the event that this court will sustain the action of the court below with respect to the preceding point, then it will be asserted that the court below erred in entering judgment in favor of the appellee United States of America for interest on its claim prior to the date of judgment. This point will be based upon the proposition that since the Renegotiation Act contains no provision for the payment of interest, and since there is no general statute providing for interest, that the only cases in which interest can be allowed are cases involving contracts entered into after the taking effect of the Act. In those instances interest has been allowed upon the theory that the right to renegotiate became a part of the contract although not expressly referred to. Consequently, interest could be charged. It will be asserted that here, on account of the fact that the contract was entered into previous to the taking effect of the Act, that there was no right to collect interest upon the basis of either an express or an implied contract.

3. The general point will be made for the reasons heretofore stated: (a), that the court below

erred in entering judgment against these appellants in any amount, and (b), that in any event and in the alternative that it erred in entering judgment against these appellants for any interest upon the claim of the Government prior to the date of judgment.

Appellants further state that it is expected that a stipulation will be entered into between these appellants and counsel for the United States of America designating the portions of the record to be printed.

Dated this 2nd day of August, 1949.

/s/ L. L. THOMPSON,
HENDERSON, CARNAHAN,
THOMPSON,

Attorneys for C. E. Bonnell and Roy T. Earley,
Appellees and Cross-Appellants.

Receipt of copy is herewith acknowledged this
2nd day of Aug., 1949.

/s/ GUY A. B. DOVELL,
Asst. U. S. Atty.

[Endorsed]: Filed Aug. 4, 1949.

IN THE
United States
Court of Appeals
FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

C. E. BONNELL, Doing business as The Bonnell
Construction Company, and ROY T. EARLEY,
Doing business as The Roy T. Earley Company,
Joint Adventurers under the Trade Name of
Bonnell Construction Company of Bremerton,

Appellees,

and

C. E. BONNELL, d/b/a The Bonnell Construction
Company and ROY T. EARLEY, d/b/a
Roy T. Earley Company, etc.,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

ON APPEAL FROM THE DISTRICT COURT OF THE UNITED
STATES FOR THE WESTERN DISTRICT OF WASHINGTON,
SOUTHERN DIVISION.

HONORABLE CHARLES H. LEAVY, *Judge*

Brief for the United States of America

J. CHARLES DENNIS,
United States Attorney

GUY A. B. DOVELL,
Assistant United States Attorney

OFFICE AND POST OFFICE ADDRESS:
324 FEDERAL BUILDING
TACOMA 2, WASHINGTON

FILED

IN THE
United States
Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

C. E. BONNELL, Doing business as The Bonnell
Construction Company, and ROY T. EARLEY,
Doing business as The Roy T. Earley Company,
Joint Adventurers under the Trade Name of
Bonnell Construction Company of Bremerton,

Appellees,

and

C. E. BONNELL, d/b/a The Bonnell Construction
Company and ROY T. EARLEY, d/b/a
Roy T. Earley Company, etc.,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

ON APPEAL FROM THE DISTRICT COURT OF THE UNITED
STATES FOR THE WESTERN DISTRICT OF WASHINGTON,
SOUTHERN DIVISION.

HONORABLE CHARLES H. LEAVY, *Judge*

Brief for the United States of America

J. CHARLES DENNIS,
United States Attorney

GUY A. B. DOVELL,
Assistant United States Attorney

OFFICE AND POST OFFICE ADDRESS:
324 FEDERAL BUILDING
TACOMA 2, WASHINGTON

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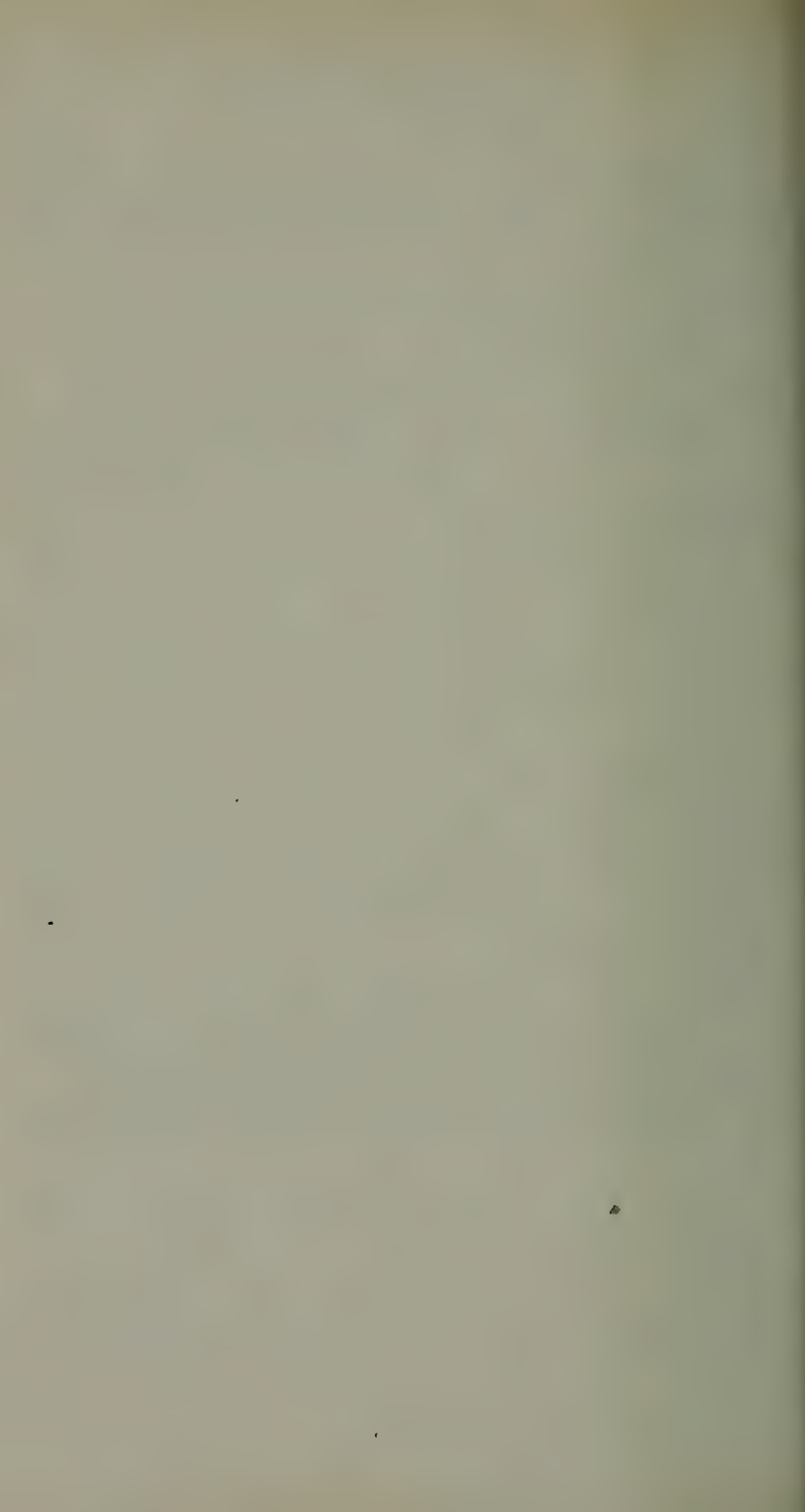
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IN THE
United States
Court of Appeals
FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

C. E. BONNELL, Doing business as The Bonnell
Construction Company, and ROY T. EARLEY,
Doing business as The Roy T. Earley Company,
Joint Adventurers under the Trade Name of
Bonnell Construction Company of Bremerton,

Appellees,

and

C. E. BONNELL, d/b/a The Bonnell Construction
Company and ROY T. EARLEY, d/b/a
Roy T. Earley Company, etc.,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

ON APPEAL FROM THE DISTRICT COURT OF THE UNITED
STATES FOR THE WESTERN DISTRICT OF WASHINGTON,
SOUTHERN DIVISION.

HONORABLE CHARLES H. LEAVY, *Judge*

Brief for the United States of America

JURISDICTIONAL STATEMENT

These appeals are taken by the United States of
America, plaintiff below, and by C. E. Bonnell and
Roy T. Earley, defendants below (which respective

designations of parties will be used in this brief to avoid confusion) from a judgment of the United States District Court for the Western District of Washington, Southern Division, which provides, in pertinent part, that plaintiff is entitled to collect interest, at the rate of three percent (3%) per annum, from defendants for the delay in payment of the net principal amount demanded pursuant to unilateral determination of excessive profits, within the meaning of the Renegotiation Act of 1942, as amended, issued and entered, on or about May 17, 1945, by the RFC Price Adjustment Board with respect to defendants' fiscal year ending December 31, 1942.

The action was begun in the court below after rejection of the offers made by defendants in amounts which did not concede the right of the government to collect interest, at the rate of six percent (6%) per annum or at all, on an unpaid renegotiation liability under a contract entered into with the government prior to the Renegotiation Act, that is, on unrefunded excessive war profits. The jurisdiction of the United States District Court over the action, and this court's appellate jurisdiction herein, are conferred by Section 403(c), Renegotiation Act of 1942, as amended; (Sec. 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, 56 Stat. 226, 245, as amended by Section 801 of the Revenue Act of 1942, 56 Stat.

798, 982; by Section 1 of the Military Appropriation Act, 1944, 57 Stat. 347; and by Act of July 14, 1943, 57 Stat. 564). Section 24(1), Judicial Code, U.S.C., Title 28, Sec. 41(1), which has been reenacted as U.S.C. Title 28, Sec. 1345 (by the Act of June 25, 1948; and U.S.C. Title 28, Sections 1291 and 1294(1)).

QUESTIONS PRESENTED

1. Is the Renegotiation Act, as amended, (56 Stat. 245, 982) to authorize renegotiation on war contracts with certain designated executive departments of the government, valid as applied to profits realized under prime contracts entered into by contractors with the government, prior to April 28, 1942, the effective date of the Act?

2. Is there a basis for allowance of interest on an unpaid renegotiation liability where the war contract involved was entered into previous to the taking effect of the Act?

3. If interest may be awarded on an unpaid renegotiation liability pursuant to contract entered into prior to enactment of Renegotiation Act, what factors should determine the rate of interest and what is the proper rate in the instant case?

STATEMENT OF PLEADINGS AND FACTS

This is an action by the United States and members of the Board of Directors of Reconstruction Finance Corporation in their official capacities to collect an amount alleged to be owed by defendants pursuant to an unilateral determination, under the Renegotiation Act, that defendants had made excessive profits on contract designated as No. W869 - Eng. 6202, during their fiscal year ending December 31, 1942. The suit was filed June 29, 1948 (R. 2 - 17). The complaint alleged that renegotiation proceedings were commenced with the defendants by the RFC Price Adjustment Board and on or about May 17, 1945, it was thereby determined that the sum of \$55,000.00 represented excessive profits; that on or about May 17, 1945 the chairman of the RFC Price Adjustment Board in compliance with law and pursuant to duly delegated authority, issued a unilateral determination and order that \$55,000 of the profits realized by the contractor during the fiscal year ended December 31, 1942, under said contract was excessive (R. 4); that on or about May 17, 1945 the defendants were duly notified of this determination and directed to repay to said board, the amount of excessive profits so determined, less the applicable tax credit, (computed at \$35,034.59) (R. 5); that no part of the amount of excessive profits so determined had been paid by de-

fendants, but that the sum of \$7,076.45 had been withheld out of funds otherwise due to defendants (R. 5). Judgment was prayed for in the sum of \$13,341.59, the net balance after the application of tax credit and withheld amount to interest and principal, plus interest on the net balance at the rate of 6% per annum from September 29, 1945, and for costs (R. 6).

Thereafter on July 20, 1948 counsel filed motions to strike and motions to dismiss on behalf of each defendant. (R. 17-20). The ground of the motions to strike involved all references to interest liability, and the ground of the motions to dismiss, as later argued, was the question of constitutionality of the Renegotiation Act in its application to a government executed contract. (R. 21); which motions were denied by order entered January 27, 1949, and defendants allowed 30 days within which to answer. (R. 20 - 22).

Defendants' answer (R. 22 - 30) admitted receiving RFC Price Adjustment Board's Determination of Excessive Profits, the same as Exhibit "B" to the complaint, and the demand as contained in Exhibit "C" to the complaint, (R. 23), the computed amount of tax credit, and withheld amount, as well as asserting a tax refund of \$307.73 not included in the complaint (R. 24), and their refusal to comply with the direc-

tion to pay voluntarily any sums of money claimed to be due under said alleged renegotiation (R. 24). As Affirmative Defenses, defendants raised the issue of renegotiation as to defendant Earley on the contract here involved without reference to renegotiation on all his other contracts; and as a further issue that the government did not pay 6% interest on its obligations, and in addition had not prosecuted its claim with such due diligence as to entitle it to be allowed that rate of interest. (R. 25 - 30).

After answer, the plaintiffs below moved, on April 22, 1949, for judgment on the pleadings on the grounds that the defendants as joint adventurers had performed the contract in question and realized profits therefrom which had been duly determined to be excessive in the sum of \$55,000.00 for the fiscal year ending December 31, 1942, and for which the defendants were liable to plaintiffs; that plaintiffs were suing to recover the net balance of \$13,341.59 remaining after application in reduction thereof of said tax credits and sums withheld which had been applied either to payment of interest theretofore accrued or to reduction of principal, (R. 31); and that the correctness of the amount claimed as excessive and the defenses pertaining thereto were in the exclusive jurisdiction of the Tax Court of the United States, and the issues of law entertainable in this court and

heretofore raised by the defendants pursuant to their motions had been determined by the district court in plaintiff's favor; that the defendants were indebted to plaintiffs in the sum of \$13,341.59, and interest from September 29, 1945, as pleaded, at such rate of interest as the court should determine proper, leaving the matter of interest and the rate, questions of law, for the decision of the court, and rendering such motion for judgment proper pursuant to Rule 12 (c) of the Federal Rules of Civil Procedure, as amended (R. 30 - 33).

The District Court was satisfied that interest should be allowed on the net amount of the claim (R. 37), but held that the rate of interest, being concededly within the discretion of the court, it was on the equity side of the law to determine what would be equitable, and thereupon fixed the rate herein at 3% instead of 6%. (R. 38).

Judgment was accordingly entered, on June 1, 1949, in favor of the plaintiffs in the sum of \$14,-240.29, principal and interest to that date, and costs taxed at \$39.00 (R. 39 - 42), the net balance having been further reduced by a tax refund of \$307.73 in addition to its reduction from recomputation of interest at 3% with consequent increased application of

credit amounts to principal theretofore applied to interest at 6%.

On this appeal, defendants contend that the provisions of the Renegotiation Act, as amended, are in violation of the Fifth Amendment to the Constitution of the United States in so far as they may be said to authorize retroactive application to prime contracts entered into by contractors with the government, prior to April 28, 1942, the effective date of said Act; and further contend that no right to collect interest upon the basis of either an express or an implied contract, as to contract entered into prior to Act, exists. (R. 54-56; 63-65).

Plaintiff, on the other hand, contends that the retroactive application of the Renegotiation Act has been determined both as to government, as well as to private contracts and maintains that defendants are legally obligated to pay interest at the rate of six percent (6%) per annum on their net principal renegotiation liability of \$13,341.59, from September 29, 1945, as more particularly set forth in its Statement of Points herein.

STATUTES AND REGULATIONS INVOLVED

I. STATUTES INVOLVED.

The original Renegotiation Act (Sec. 403 of the

Sixth Supplemental National Defense Appropriation Act, 1942, 56 Stat. 226, 245) and its various amendments (Sec. 801 of the Revenue Act of 1942, 56 Stat. 798, 982; Sec. 1 of the Military Appropriation Act, 1944, 57 Stat. 347; the Act of July 14, 1943, 57 Stat. 564; Titles VII and VIII of the Revenue Act of 1943, 58 Stat. 21, 78; and the Act of June 30, 1945, 59 Stat. 294, 50 U.S.C. App. 1191), which with exception of 1945 Act relating to termination date of the Renegotiation Act are pertinent to the present case.

Remington's Revised Statutes of Washington, Section 7299, which in pertinent portion is as follows:

“Every loan or forbearance of money, goods, or thing in action shall bear interest at the rate of six per centum per annum where no different rate is agreed to in writing between the parties.
* * * *”

II. REGULATIONS INVOLVED.

Section 622, Joint Renegotiation Manual:

“It is proper procedure to make a demand for payment in connection with an unilateral determination and state in such demand that interest will accrue at the rate of 6% per annum from and after a date inserted in the demand on any amount due under such unilateral determination and unpaid. The date ordinarily to be inserted in the demand will be approximately fifteen days from the date of the unilateral determination but the Department issuing the unilateral determination may provide for a greater or lesser time. The time to be allowed is in the discretion of the

Department and should be a reasonable time considered equitable under the circumstances, in view of the necessary time for mailing and for obtaining computation of the tax credit (pursuant to Section 3806, Internal Revenue Code).

Section 626.2(3), Renegotiation Regulations, applicable to renegotiation of fiscal years ending after June 30, 1943 contains the following:

"Interest at the rate of 6% per annum accrues upon the amount determined as excessive profits to be eliminated less the tax credit, if any (pursuant to Section 3806, Internal Revenue Code) from and after the date fixed in the demand for payment."

STATEMENT OF POINTS

1. That the District Court erred in determining that 3% per annum is a proper rate of interest to be allowed plaintiff on its claim involved in this action, instituted June 29, 1948, to collect excessive profits, less credits, owed by defendants pursuant to unilateral determination, under the Renegotiation Act, that defendants realized excessive profits on a war contract during their fiscal year ending December 31, 1942.

2. That the District Court erred in fixing the rate of interest to be allowed on plaintiff's claim herein on the basis of what rate of interest the government would have paid for the use of equivalent funds pending payment of said claim, as a fair and

just compensation for defendants' failure and refusal to make payment upon demand.

3. That plaintiff is entitled to interest at the rate of 6% per annum upon the amount determined as excessive profits to be eliminated less tax credits and tax refund as set out in the pleadings contained in the record herein, from and after the date fixed in the demand for payment.

4. That plaintiff is entitled to recover judgment in the sum of \$13,341.59 as principal balance due on its claim, plus interest thereon at the rate of 6% per annum from September 29, 1945, as prayed for in its complaint, less a withheld tax refund of \$307.73 of April 6, 1948, as deductible from the amount of said interest, making a total as of June 1, 1949, the date of entry of judgment, in the sum of \$15,974.84, principal and interest at said rate.

ARGUMENT

A. "THE RENEGOTIATION ACT, INCLUDING ITS AMENDMENTS, HAS BEEN PROPERLY APPLIED TO CONTRACTS ENTERED INTO BEFORE ITS AND THEIR RESPECTIVE ENACTMENTS."

The Supreme Court in *Lichter v. United States*, 334 U. S. 742, at page 788, headed its discussion of

retroactivity with the foregoing statement, and further stated:

“Congress limited the Renegotiation Act to future contracts and to contracts already existing but pursuant to which final payments had not been made prior to the date of enactment of the original Act. These included contracts made directly with the government and also subcontracts such as those here involved.”

And within the limits so expressed, the Supreme Court in *Lincoln Electric Co. v. Forrestal*, 334, U.S. 841, decided per curiam the same day as, and on the authority of *Lichter v. United States*, supra, the issue herein in favor of the Act's validity.

In the Lincoln Electric case, the secretary of the Navy included in the contractor's renegotiable business upon which the Secretary's unilateral order was based, sales in the calendar year 1942, to Departments of the United States and their contractors and subcontractors. Since the Supreme Court, unlike the District Court (77 F. Supp. 444, 447) decided the merits of the controversy, it necessarily determined all the constitutional issues raised by the contractor as to the invalidity of the Act and its amendment.

Defendants find no fault with the general principles of retroactivity applied to parties and to contracts not with the government.

It is the position of defendants that “an exercise

of the sovereign right of the government to protect * * * the general welfare of the people", a power which is "paramount to any rights under contracts between individuals" should yield to the constitutional immunity of an isolated private contract from impairment to its proceeds.

See, in this connection, *Manigault v. Springs*, 199 U.S. 473, 480; *Norman v. Baltimore & Ohio R. Co.* 294 U.S. 240, 307 - 308; *Veix v. Sixth Ward Ass'n*, 310 U.S. 32; *East New York Savings Bank v. Hahn*, 326 U.S. 230, 232; *Hamilton v. Kentucky Distilleries Co.*, 251 U.S. 145, 156; *Richmond Corp. v. Wachovia Bank*, 300 U.S. 124; *Honeyman v. Jacobs*, 306 U.S. 539; and *Home Building & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 435.

The Constitution does not prohibit retrospective legislation as such, and the mere fact that a statute is retroactive in its operation does not make it repugnant to the Federal Constitution.

League v. Texas, 184 U.S. 156, 161;
Calder v. Bull, 3 Dall, 386;
Watson v. Mercer, 18 Pet. 88, 109;
Blount v. Windley, 95 U.S. 173, 180.

The Supreme Court has from early days sustained the validity of much legislation having a retroactive effect on existing property rights.

Watson v. Mercer supra; Curtis v. Whitney,
13 Wall. 68.

This principle is not different when the property rights happens to be a contract.

Calhoun v. Massie, 253 U.S. 170, 176.

We do not believe it is defendant's intention to argue that federal employees are entitled to receive and hold their compensation free and clear of future income tax legislation, or against the validity in such case of retroactive income tax legislation.

See *Baker v. Commissioner of Internal Revenue* 149 F. (2d) 342, cert. den. 326 U.S. 746.

Retroactive income taxation, which has long been held valid, is an especially forceful analogy to the recovery of net profits realized under executed contracts.

Cooper v. United States, 280 U.S. 409;

Welch v. Henry, 305 U.S. 134, 148.

As this court has stated in *Spaulding v. Douglas Aircraft Co., Inc.*, 154 F. (2d) 419, 423 " * * * the power in war to recapture for the war treasury excessive profits from existing contracts is certainly as great as the power in peace to tax in a succeeding year the income earned prior to the tax legislation".

In support of their position, the defendants rely in particular on *Lynch v. U. S.*, 292 U.S. 571, and *Perry v. U. S.*, 294 U.S. 330 (R. 64). The Lynch case involved policies of war risks insurance and raised the question of taking property without making just compensation. The instant case involves taking or recapturing excessive profits over and above just compensation. If the objection of taking property without making just compensation could be raised as to recapturing excessive profits on renegotiation, then the same objection would be applicable to any and all forms of taxation.

While the Perry case sustains the contractual effectiveness of the gold clause as between government and citizen, that case, however, involved no application of the war powers of Congress, and offers no assistance.

National Electric Welding Machines Co. v. Stimson, 10 T.C. No. 8.

B. (1) INTEREST IS PROPERLY ALLOWABLE ON AN UNPAID RENEGOTIATION LIABILITY NOTWITHSTANDING THE WAR CONTRACT INVOLVED WAS ENTERED INTO PREVIOUS TO THE TAKING EFFECT OF THE ACT.

It is a long established tenet of the law that interest runs from the date of default to the date of

payment, upon an obligation to pay money. That legal principle was recognized early, and has been consistently maintained by the Supreme Court of the United States. In the early case of *Curtis, et al v. Innerarity, et al* (1848) 6 How. (U.S.) 146, the Supreme Court succinctly stated (p. 154):

“It is a dictate of natural justice, and the law of every civilized country, that a man is found in equity, not only to perform his engagements, but also to repair all the damages that accrue naturally from their breach. Hence, every nation, whether governed by the civil or common law, has established a certain common measure of reparation for the detention of money not paid according to contract, which is usually calculated at a certain and legal rate of interest. Everyone who contracts to pay money on a certain day knows, that, if he fails to fulfill his contract, he must pay the established rate of interest as damages for his non-performance. Hence, it may correctly be said, that such is the implied contract of the parties. * * * ”

The principle enunciated by the Supreme Court in the Curtis case, *supra*, has been followed precisely in many of its subsequent decisions. For example, in the well known case of *Young v. Godbe* (1872) 15 Wall. (U.S.) 562, which involved an action on an account stated, the court held that interest should run upon a breach of an agreement to pay money, even though such agreement did not expressly provide for interest, and pointedly said (pp. 565-566):

“ * * * If a debt ought to be paid at a particular time, and is not owing to the default of the debtor, the creditor is entitled to interest from that time by way of compensation for the delay in payment. And if the account be stated, * * *, interest begins to run at once.

It is said there is no law in the territory of Utah prescribing a rate of interest in transactions like the one in controversy in this suit, and that therefore, no interest can be recovered. But this result does not follow. If there is no statute on the subject, interest will be allowed by way of damages for unreasonably withholding payment of an overdue account. The rate must be reasonable, and conform to the custom which obtains in the community in dealings of this character.”

A more recent reiteration of the principle may be found in *Royal Indemnity Co. v. United States* (1941) 313 U.S. 289, where, in a suit brought upon a surety bond running to the government, the Supreme Court declared (pp. 296 - 297) :

“* * * And in the meantime the debtor has had the use of the money, of which its default has deprived the creditor. Interest upon the principal sum from the date of default, at a fair rate, is therefore an appropriate measure of damage for the delay in payment. * * *”

The principle that interest, computed from date of default to date of payment, may be collected on an obligation to pay money, has been held to be as fully applicable to such an obligation arising from uni-

lateral action taken by the government, as it is when the obligation derives from a contract.

See for example *Railroad Co. v. United States* (1879), 101 U.S. 543; *United States v. Erie Railway Company* (1882), 106 U.S. 327; *United States v. Mexican International R. Co.* (C.C.W.D. Texas, 1907), 154 Fed. 519, in each of which the right of the government to interest on unpaid obligations for customs duties or for taxes was upheld.

Those earlier holdings were expressly approved by the Supreme Court in *Billings v. United States*, (1914) 232 U.S. 261, which decided that interest accrued on unpaid federal taxes, although the pertinent tax statute contained no provision therefor. In the opinion in the *Billings* case, the Supreme Court made the following significant pronouncement. (P. 286):

“ * * * Thus, as to the necessity for a statute it was long ago here decided in view of the true conception of interest, that a statute was not necessary to compel its payment where in accordance with the principles of equity and justice in the enforcement of an obligation, interest should be allowed. *Young v. Godbe*, 15 Wall. 562, 565:

* * * * *

“And the decisions of this court have often since exemplified the principle by considering the question of the responsibility for interest from the point of view of reason and justice, even though no express statute existed for compelling this

payment. So also as to the nature and character of the obligation to pay taxes. * * *

The law is settled that unpaid liabilities of stockholders in a national bank, resulting from assessments made by the comptroller of the currency, do bear interest. In the leading case of *Casey v. Galli* (1876), 94 U.S. 673, the Supreme Court ruled that (pp. 677 - 678):

“ * * * The sum to be paid being liquidated, and due and payable when the comptroller's order was made, it follows that the amount bears interest from the date of the order. *Otherwise there would be no motive to pay promptly, and no equality between those who should pay then and those who should pay at the end of a protracted litigation.* * * *

(Italics supplied)

To the same effect, see *Bowden v. Johnson* (1882), 107 U.S. 251, 263; *Garvy v. Wilder* (C.C.A. 7, 1941), 121 F. (2d) 714.

It would, therefore, appear that in the absence of a statutory provision to the contrary, the government is entitled to interest on an obligation owed to it.

See *Billings v. United States* supra;
Board of Commissioners v. United States, 308 U.S. 343.

It should be pointed out that although there is no language in the Renegotiation Act, as amended, or in any other Act of Congress, which specifically

allows or forbids interest on renegotiation liabilities either prior to payment or prior to judgment, as the case may be, the courts have consistently held that the government is entitled to collect interest on unpaid renegotiation debt owed to it. Such cases are numerous and with no exception whatever, have to date, fully recognized that determinations of excessive profits, made pursuant to the Renegotiation Act, as amended, are obligations for the payment of money to the government, and, in accordance with the legal principle hereinbefore set forth, bear interest. Included in the list of such cases are the following decisions of this court:

Sampson Motors, Inc. v. United States, 168 F. (2d) 878; *United States v. Eason Grinding Company*, Civil Nos. 5032 and 5445, D.C. S.D. Calif., C. Div., April 19, 1947, aff'd per curiam, C.C.A. 9th Cir. April 25, 1949.

(2) The Government is entitled to collect interest at the rate of six percent (6%) per annum on Renegotiation Debts Arising from Determinations of Excessive Profits Made Pursuant to the Renegotiation Act, as Amended.

All of plaintiff's specifications of error, Points I to IV, inclusive, embody practically the same subject matter and the plaintiff's argument as to one will

apply with equal force to all. Therefore, they will be discussed together.

An examination and analysis of pertinent Congressional policy, judicial precedents, administrative regulations and analogous statutes fully support the government's position herein that the proper rate of interest to which it is entitled on unpaid renegotiation debts, such as owed by the defendants, is six percent (6%) per annum.

(a) CONGRESSIONAL POLICY.

Defendants were renegotiated pursuant to the Renegotiation Act of 1942, as amended, by the RFC Price Adjustment Board for the purpose of eliminating excessive profits, within the meaning of that Act, realized by defendants during their fiscal year ending December 31, 1942 (R. 4). That Act, which applies to renegotiation of contractors and subcontractors for fiscal periods ending before July 1, 1943, clearly indicates that Congress intended that the refund of War Profits, found to be excessive should be accomplished with the utmost dispatch. To carry a policy of speedy collection of unpaid renegotiation debts into effect, Congress has provided strong and broad administrative methods of making such collection.

Section 403(c) of the Renegotiation Act of 1942

as originally enacted (Sixth Supplemental National Defense Appropriation Act; Act of April 28, 1942; Public Law 528, 77th Congress; 2d Sess.) provided:

“(c) The Secretary of each Department is authorized and directed, whenever in his opinion excessive profits have been realized, or are likely to be realized, from any contract with such Department or from any subcontract thereunder, (1) to require the contractor or the subcontractor to renegotiate the contract price, (2) to withhold from the contractor or subcontractor any amount of the contract price which is found as a result of such renegotiation to represent excessive profits, and (3) in case any amount of the contract price found as a result of such renegotiation to represent excessive profits shall have been paid to the contractor or subcontractor to recover such amount from such contractor or subcontractor. Such contractor or subcontractor shall be deemed to be indebted to the United States for any amount which such Secretary is authorized to recover from such contractor or subcontractor under this subsection, and such secretary may bring actions in the appropriate courts of the United States to recover such amount on behalf of the United States. All amounts recovered under this subsection shall be covered into the Treasury as miscellaneous receipts. This subsection shall be applicable to all contracts and sub-contracts hereafter made and to all contracts and subcontracts heretofore made, whether or not such contract or subcontracts contain a renegotiation or recapture clause. Provided that final payment pursuant to such contract or subcontract has not been made prior to the date of enactment of this Act.”

Following the enactment of the Renegotiation

Act, the Secretaries of the several Departments named therein put into effect an administrative policy of eliminating excessive war profits as quickly as possible, by the recourses granted them including an interest charge of six percent (6%) per annum as a deterrent to non-payment of such excessive profits to the government.

To secure clarifying amendments, which if made into law, would merely ratify existing administrative practice, the War and Navy Departments proposed the same, which were enacted by Congress. See Section 403(c) (2) of the Renegotiation Act of 1942, as amended. That section, originally being found in Section 801(a), Revenue Act of 1942 (Act of October 21, 1942; Public Law 753, 77th Cong., 2d Sess.) provides, in pertinent part:

“(2) Upon renegotiation, the Secretary is authorized and directed to eliminate any excessive profits under such contract or subcontract (i) by reductions in the contract price of the contract or subcontract, or by other revision in its terms; or (ii) by withholding, from amounts otherwise due to the contractor or subcontractor, any amount of such excessive profits; or (iii) by directing a contractor to withhold for the account of the United States, from amounts otherwise due to the subcontractor, any amount of such excessive profits under the subcontract; or (iv) by recovery from the contractor or subcontractor, through repayment, credit or suit, of any amount of such excessive profits actually

paid to him; or (v) by any combination of these methods, as the secretary deems desirable. The secretary may bring actions on behalf of the United States in the appropriate courts of the United States to recover from such contractor or subcontractor, any amount of such excessive profits actually paid to him and not withheld or eliminated by some other method under this subsection. * * *"

It is submitted that, by the latter amendment to the original 1942 Renegotiation Act, Congress, in effect, approved and ratified the prior and existing administrative construction of and practice under Section 403(c) *supra*, including the collection of six percent (6%) per annum interest on unpaid renegotiation liability.

In the meantime publications of administrative interpretation of the 1942 Renegotiation Act, as amended, were made. See, Principles, Policy and Procedure to be followed in Renegotiation, issued by the War Department on August 10, 1942; Joint Statement by the War, Navy and Treasury Departments and the Maritime Commission, published on March 31, 1943; and Joint Renegotiation Manual, pertaining to fiscal periods ending prior to July 1, 1943, and promulgated January 27, 1944. Section 622, Joint Renegotiation Manual, provided, and still provides, that interest, at the rate of six percent (6%) per annum, shall be collected on unpaid renegotiation

debts due to the government as a result of unilateral determination of excessive profits for fiscal periods ending prior to July 1, 1943.

Congress was aware of and knew of the Regulation, when it subsequently enacted the Renegotiation Act of 1943 (Section 701, Revenue Act of 1943; Act of February 25, 1944; Public Law 235, 78th Cong., 2d Sess.) The latter Act, relating to elimination of excessive war profits for fiscal years ending after June 30, 1943, contains the following pertinent provisions (Sec. 403(c) (2) thereof):

“(2) Upon the making of an agreement, or the entry of an order (unilateral determination of excessive profits), under paragraph (1) by the (War Contracts Price Adjustment) Board, * * *, determining excessive profits, the Board *shall forthwith authorize and direct* the Secretaries or any of them to eliminate such excessive profits (A) by reductions in the amounts otherwise payable to the contractor under contracts with the Departments, or by other revision of their terms; or (B) by withholding from amounts otherwise due to the contractor any amount of such excessive profits; or (C) by directing a contractor to withhold for the account of the United States, from amounts otherwise due to a subcontractor, any amount of such excessive profits of such subcontractor; or (D) by recovery from the contractor, through repayment, credit or suit any amount of such excessive profits actually paid to him; or (E) by any combination of these methods as is deemed desirable. Actions on behalf of the United States may be brought in the appropriate courts of the United States to recover from

the contractor any amount of such excessive profits actually paid to him and not withheld or eliminated by some other method under this subsection. * * *

(Italics supplied).

This section became law on February 25, 1944, effective date of the 1943 Renegotiation Act. On March 3, 1944, the War Contracts Price Adjustment Board promulgated its Renegotiation Regulations for renegotiation pursuant to the Renegotiation Act of 1943, relating to fiscal periods ending after June 30, 1943. Section 626.2(3), Renegotiation Regulations, provided, and still provides, that unpaid amounts due to the government, as a result of renegotiation within the provisions of the 1943 Renegotiation Act, shall be collected, with interest thereon at the rate of six percent (6%) per annum.

The 1943 Act provided for redeterminations de novo of excessive profits by the Tax Court of the United States, at the option of a contractor or subcontractor aggrieved by a unilateral determination of excessive profits and within a stated time limit. Since these provisions 403(e) (1) and (2) permit the Tax Court to make a redetermination of such excessive profits at an amount less than, equal to, or greater than the original determination involved in the de novo proceeding, Congress had to provide funds for

the refund of payments of renegotiation debts, made by contractors and subcontractors who subsequently might be successful in securing a reduced determination of excessive profits in a Tax Court proceeding. Such funds were made available by Congress in the following appropriation acts:

(1) Public Law 40, 79th Cong., 1st Sess. relating to the fiscal year ending June 30, 1946;

(2) Public Law 521, 79th Cong., 2nd Sess. relating to the fiscal year ending June 30, 1947;

(3) Public Law 271, 80th Cong., 1st Sess. relating to the fiscal year ending June 30, 1948; and

(4) Public Law 640, 80th Cong., 2nd Sess. relating to the fiscal year ending June 30, 1949.

Each of these appropriation acts provides for refund of renegotiation payments to contractors or subcontractors successful in the Tax Court, after they have made such payments to the several Secretaries of the Departments named in the 1942 Renegotiation Act, as amended, or to the War Contracts Price Adjustment Board under the 1943 Act, with interest on such refunds at not to exceed four percent (4%) per annum. These several Acts made no provision that the rate of interest known to be collected on unpaid renegotiations liabilities owed to the government,

that is, six per cent (6%) per annum, should be correspondingly reduced to four percent (4%) per annum.

It is submitted that, when Congress, with full awareness of the existing administrative interpretation of the "collection provisions" of the 1942 Renegotiation Act, as originally passed and as amended, and also of the 1943 Act, *supra*, enacted the amendments made in the 1942 Renegotiation Act by the Act of October 21, 1942, *supra*; enacted Section 403(c) (2) of the Renegotiation Act of 1943, *supra*; and enacted the successive renegotiation refund appropriation acts listed, *supra*, it thereby approved and ratified the administrative construction of, and the administrative practice in applying, such "collection provisions" of the respective Renegotiation Acts. The interpretation of a statute by an agency charged with its administration, during a period when Congress is legislating on the same subject matter, is indicative of Congressional intent that such interpretation is to continue.

Biddle v. Commissioner (1938), 302 U.S. 573; *United States v. Shreveport Grain Elevator Co.* (1932) 287 U.S. 77; *McCaughn v. Hershey Chocolate Co.* (1928), 283 U.S. 488; *Iselin v. United States* (1926), 270 U.S. 245.

The clearly-expressed Congressional policy to effect expeditious recovery and collection by the government of unpaid renegotiation liabilities owed to it by contractors and subcontractors, and the manifest need to charge interest on such unpaid debts at a rate per annum sufficient to deter the withholding of such money from the government, especially during the war period of necessarily-high governmental expenditures, has been plainly expounded and succinctly stated in *United States v. Strontium Products Co., et al*, 68 F. Supp. 886, 888.

“ * * * *The tenor of the Act clearly reveals a Congressional purpose to effect speedy collection. The provision authorizing review by the Tax Court is specifically limited so as to not operate ‘to stay the execution of the order of the Board’. Various means are provided to speed recovery; by withholding money owed to the contractor, by revision of contracts, by ordering third parties to withhold, by repayment, credit or suit, or by any combination of these methods. Such a statutory policy makes it essential to exact interest from the contractor who refuses to pay, and who retains the use of the money while depriving the government of its use, so as not to penalize prompt contractors who comply with the letter and spirit of the Act.*” (Italics supplied).

The Strontium case is cited with unqualified approval by this court in *Sampson Motors, Inc. v. United States* (C.C.A. 9, 1948), 168 F. (2d) 878, 879, awarding interest, at six percent (6%) per annum,

on an unpaid renegotiation liability owed to the government.

The defendants by way of objection to the allowance of the rate of 6% set up in their Answer (R. 27-29) the proposition that it would be inequitable to charge such rate where an Assistant Attorney General, Mr. John F. Sonnett, then in charge of the claim, had not advised the defendants of the Department's final position on the matter in due course following their offer of compromise and settlement. Parenthetically, it may be stated here that Mr. Sonnett had been placed at the head of the important anti-trust litigation and had ceased to be connected with the matters in question.

The plaintiffs below moved for judgment on the pleadings (R. 30) without delaying the action by entry of denial of defendants' alleged cause of prior delay. The District Court, assuming thereupon that the government was "at least as culpable as the defendant in this case" determined that it would be doing equity to reduce the rate of interest to somewhere between what the government would have been compelled to pay and what the defendants would have had to pay for money borrowed (R. 36-38). This, the court below proceeded to do without any proof taken or allegations made as to what damage,

if any, the defendants had suffered by reason of the plaintiff's failure to make earlier answer to their offer or as to what the loan of the excessive profits funds had earned for the defendants in their contracting business during the interim. Certainly, the principles of equity required that the court take into consideration in the first place what damage, if any, the defendants had suffered by not being given earlier notice of their offer's rejection rather than, upon the open charge of delay, to place the penalty therefor upon the government. Nor is there any allegation or showing or any reason disclosed by the record to conclude that an earlier rejection would have resulted in earlier payment being made by defendants. Defendants were content to sit by and not avail themselves of the opportunity for speedy relief, if entitled to any, by taking their grievances to the Tax Court, and should not now be heard to complain of any delay attending offers in compromise, which whether so designed or not, afforded the defendants an opportunity to look forward to and take advantage of whatever the future held in the way of more favorable decisions, or legislation relating to such matters then pending.

Confronted with consideration of the factors used by the court below in arriving at a rate of interest,

the court in *United States v. Strontium Products Co. et al*, 71 F. Supp. 475, 477, pointedly stated:

“As to the rate of interest, defendants (that is, the renegotiated contractor) insist that since the Act (that is, the pertinent refund appropriation act) provides for payment of interest on refunds at a rate not in excess of four percent, it would be inequitable to exact interest from defendants at a greater rate. *The fact that interest rates vary according to a borrower's financial standing is a proper subject of judicial notice.* Banks are quite willing to loan money to the government at a lower rate than that which they would consider a proper rate for the ordinary commercial borrower. *Four percent has long been considered an ample rate of interest on a government obligation; but even in these days of cheap money, the accepted and legal commercial rate for the use of money is six percent.* The fact that defendants kept in their bank account a large amount of money, enough to have paid the sum which they admitted they owed, cannot excuse them from paying interest on that amount, along with the remainder. The money was in their control, and they could have used it for their own purposes. *In my opinion, to fix any other rate of interest than six percent would be an abuse of discretion on the part of the court, and might encourage others to be slow in paying government assessments or awards.* Therefore, the rate of interest in this case will be fixed at six percent.” (Italics supplied).

To the same effect, see also *Sampson Motors Inc., v. United States*, *supra*.

That the collection of renegotiated excessive war profits is not a penalty, is constitutional under the

Fifth Amendment of the Constitution of the United States, and is a recovery of the government's own money received by the renegotiated contractor or subcontractor as an overcharge, have been plainly recognized by the Supreme Court.

See *Lichter, et al v. United States*, 334 U.S. 742, 787.

(b) JUDICIAL PRECEDENTS.

In addition to the cases already discussed, interest at the rate of six percent per annum has been awarded to the government on unpaid renegotiation debts, in spite of opposition thereto by the respective contractors or subcontractors, in a number of cases unreported or where the fact thereof does not appear in the written decisions. For example, see *Hickey & Company v. United States*, 168 F. (2d) 752, affirming per curiam *United States v. Hickey*, 70 F. Supp. 13.

An analysis of the classic line of leading cases, wherein the Federal courts have awarded interest to the government on unpaid debts owed to it, despite the absence of specific statutory provision therefor, discloses the following, wherein 6% was allowed:

Railroad Co. v. United States, 101 U.S. 543;

United States v. Erie Railway Company, 106 U. S. 327;

Billings v. United States, 232 U.S. 261; and *Royal Indemnity Co. v. United States*, 313 U.S. 289, all involving unpaid taxes.

And in *United States v. Mexican International R. Co.*, 154 Fed. 519, involving unpaid customs duties, the court in Texas applied the pertinent statute of that state, providing for 6% in the absence of express agreement to the contrary, as did the court in New York in the *Royal Indemnity* case, *supra*, measuring the award of interest by the law of New York fixing the rate of 6% in such cases.

(c) ADMINISTRATIVE REGULATIONS.

Pursuant to regulation, the demand for payment served on defendants included notice of the charge of interest at the rate of 6% per annum on the net amount due. (R. 16).

Such administrative regulations have been held by the courts to be "persuasive" and "worthy of substantial consideration."

See *United States v. Strontium Products Co., et al*, 68 F. Supp. 886, 888, *supra*, and *Sampson Motors, Inc. v. United States*, *supra*.

(d) ANALOGOUS STATUTES.

An examination of the local statute, applicable

to the case at bar indicates that six percent (6%) per annum is the proper rate of interest to allow the government on defendant's renegotiation liability.

Although they are not necessarily bound by such local statutes, the Federal courts may turn to them for guidance in determining the rate of interest to be awarded to the government in suits to collect obligations owed to it. That principle was plainly recognized and affirmed by the Supreme Court in *Royal Indemnity Co. v. United States*, supra, wherein it stated (p. 297):

“ * * * Interest upon the principal sum from the date of default, at a fair rate, is therefore an appropriate measure of damage for delay in payment. * * * While the New York statute fixing the rate of interest (at 6%) is not controlling, the allowance of interest does not conflict with any state or federal policy, and we think that, in the circumstances of this case, a suitable rate is that prevailing in the state where the obligation was given and to be performed. * * * ”

See also, *United States v. Mexican International R. Co.*, supra.

(e) APPLICATION OF TAX REFUND TO INTEREST:

The District Court deducted a withheld tax refund of \$307.73 of April 6, 1948 (R. 41-42) from the principal balance due. It is the contention of plaintiff (Statement of Points IV; R. 59-60) that a payment

should be applied first to reduction of interest due and the remainder, if any, to principal in accordance with the custom employed in commercial transactions, and that the method of eliminating the principal due, without consideration given to the interest is it is contended a practice which disregards the rights of the lender and has neither basis in logical calculation nor a foundation in accepted commercial practice.

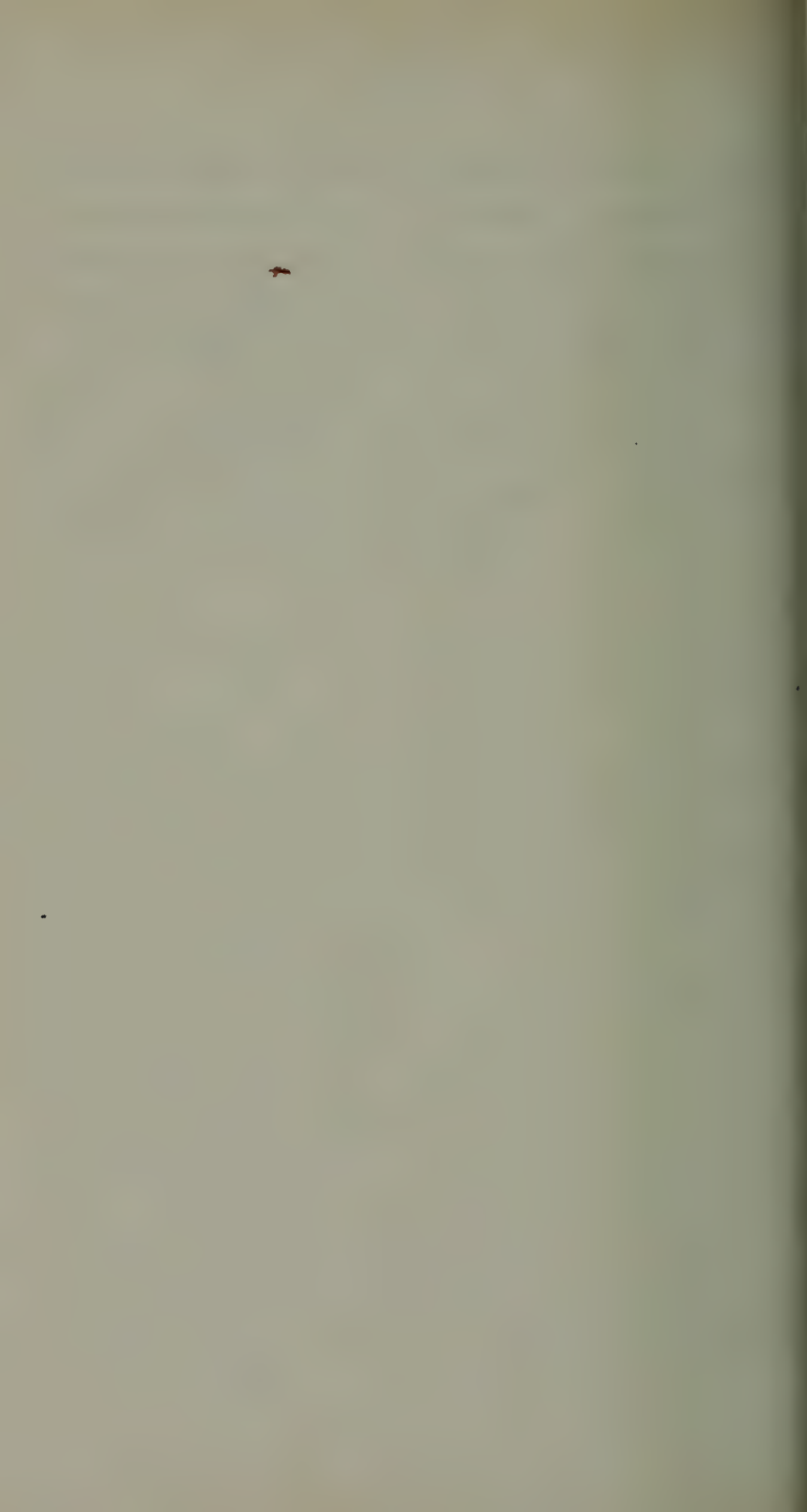
CONCLUSION

For the reasons set forth above, plaintiff respectfully submits that the decision of the United States District Court for the Western District of Washington, Southern Division, should be reversed, insofar as it restricted the government's right to collect interest on defendant's renegotiation debt to three percent (3%) per annum and insofar as it applied the tax refund payment of \$307.73 to discharge of part of the principal amount instead of to accrued interest, and that the case should be remanded to the court below, with instructions to enter judgment for the government for interest, to be computed at six percent (6%) per annum, on defendant's renegotiation liability from and including the date of demand fixed by the Treasurer of the RFC Price Adjustment Board to and including the date of payment thereof, and that the withheld tax refund of \$307.73 of April 6,

1948, be deducted from the amount of said interest, and judgment be entered for the principal balance of \$13,341.59 plus interest at the rate of 6% per annum from September 29, 1945, as prayed for in the complaint, less said withheld tax refund of \$307.73.

J. CHARLES DENNIS,
United States Attorney

GUY A. B. DOVELL,
Assistant United States Attorney



No. 12306

IN THE
United States
Court of Appeals
FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

C. E. BONNELL, doing business as The Bonnell Construction Company, and ROY T. EARLEY, doing business as the Roy T. Earley Company, Joint Adventurers under the Trade Name of Bonnell Construction Company of Bremerton,

Appellees,

and

C. E. BONNELL, d/b/a The Bonnell Construction Company and ROY T. EARLEY, d/b/a Roy T. Earley Company, etc.,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

ON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR
THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE CHARLES H. LEAVY, *Judge*

MOTION TO DISMISS APPEAL AND
BRIEF OF C. E. BONNELL AND ROY T. EARLEY

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HONORABLE CHARLES H. LEAVY, *Judge*

MOTION TO DISMISS APPEAL AND
BRIEF OF C. E. BONNELL AND ROY T. EARLEY

MOTION TO DISMISS APPEAL

Come now C. E. Bonnell and Roy T. Earley, appellees on the appeal of United States of America herein, and move that the appeal of the United States be dis-

missed for the reason and upon the ground that the portion of the judgment from which an appeal is sought to be taken is not subject to an appeal or a review by this Court. This motion is based upon the records and files herein.

L. L. THOMPSON,
HENDERSON, CARNAHAN & THOMPSON,
Attorneys for Bonnell and Earley.

POINTS AND AUTHORITIES ON MOTION TO DISMISS

The Notice of Appeal given by the Government is not a general appeal from the judgment but an appeal from the action of the Court below in fixing an interest rate of 3% upon the amount of the Government's claim instead of 6% as demanded (R. 44).

The brief of the Government concedes that the question of the rate of interest to be allowed was "concededly within the discretion of the Court" (R. 7). The same concession was also made at the hearing in the Court below because at that hearing the Court inquired whether the contention of the Government was that the rate "should be 6% and no less than that," to which counsel for the Government replied that "it ought to be 6% but my contention is that is within the discretion of the Court" (R. 37).

Nowhere, in the brief, is there any claim made that

the Court below failed to exercise the discretion which the Government conceded the Court possessed. No decision of this or any other Court or any statute is cited which made it mandatory upon the District Court to fix an interest rate of 6%. The facts are not in dispute, since the matter came before the Court upon the Government's Motion for Judgment on the Pleadings. The brief does no more than to disagree with the conclusion reached by the trial Court in a discretionary matter and by it the Government seeks to induce this Court to consider the question de novo and to, in effect, exercise a discretion which was vested in the District Court.

It is familiar law that no appeal lies from the discretionary order of a Court of original jurisdiction in the absence of a showing that such Court acted arbitrarily or capriciously, or perhaps failed to exercise its discretion.

“It is a general rule that an Appeal, Writ of Error or Exceptions will not lie from or to the action of a Court in the exercise of its purely discretionary powers, unless the right to review is given by statute, or unless there has been an abusive discretion.”

4 Corpus Juris (2d), 207.

Among the cases cited to support this statement is the decision of this Court in *Barceloux vs. Buffum*, 51 Fed. (2d) 82, where this Court dismissed an appeal

taken from an order of the Court below refusing to permit an intervention where the intervenor was not able to show a vested right to intervene.

See also *Steinjer Patents Corporation vs. Meyerson*, 49 Fed. (2d) 765, and cases cited therein.

It is therefore submitted that the Government's appeal should be dismissed.

The following portion of this brief is intended to cover the appeal of Bonnell and Earley from the judgment and also to discuss the question of interest rate, upon the assumption that the foregoing Motion to Dismiss is denied.

QUESTIONS PRESENTED

We accept Statements 1 and 2 of the Government's brief (Brief page 3) as correct statements of the questions presented on the appeal of Bonnell and Earley and therefore make them a part hereof by reference. If the foregoing Motion to Dismiss the Government's appeal is granted, these will be the only questions presented. If, however, the motion is denied, then in lieu of Statement 3 as set forth in the Government's brief, the following is submitted:

3. If interest may be awarded on an unpaid renegotiation liability arising out of a contract entered into prior to the enactment of the Renegotiation Act, then

is there any evidence to show that the District Court abused its discretion in fixing the rate of interest at 3%, instead of 6%, as asked by the Government.

STATEMENTS OF PLEADINGS AND FACTS

We accept the Statement of Pleadings and Facts set forth in the Government's brief, except (1) we reserve the right to amplify the statement in connection with our argument, and (2) we think there should be added thereto this additional statement.

The Government's brief (page 7) sets forth a correct statement of the judgment entered and makes reference to the fact that the net balance conceded under the pleadings was further reduced "by a tax refund of \$307.73 in addition to its reduction from recomputation of interest at 3% with consequent increased application of credit amounts to principal theretofore applied to interest at 6%." Subsequent portions of the brief assert error on the part of the Court below in that it is contended that this additional credit, which is not controverted, should have been applied first to the reduction of interest and not to principal (Brief page 35). The oral decision of the Court made no reference to this item but merely ordered the interest rate to be applied to be reduced from 6% to 3% and a credit allowed and ordered the attorney for the Government to prepare a judgment accordingly (Tr. page 38). The

judgment was prepared by counsel for the Government and the computations were made by counsel for the Government and if there was error in the application of this item it was the error of Government's counsel and not that of the Court (Tr. p. 43).

STATEMENT OF POINTS

1. That the District Court erred in denying appellants Motion to Dismiss the action and in holding that the Renegotiation Act, insofar as it sought to subject to renegotiation the profits of prime contracts entered into with the Government prior to the taking effect of the Act, was in violation of the Constitution of the United States, particularly the Fifth Amendment thereto.

2. That the District Court erred in denying appellants Motion to Strike from the complaint all reference to interest and holding that any interest could be charged against the appellants.

3. Generally that the District Court erred in entering any judgment against the appellants, either in the principal sum or for interest.

ARGUMENT

THE RENEGOTIATION ACT VIOLATES THE FIFTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES INsofar AS IT

SEEKS TO SUBJECT TO RENEGOTIATION THE PROCEEDS ARISING OUT OF A PRIME CONTRACT MADE WITH THE GOVERNMENT PRIOR TO THE TAKING EFFECT OF THE ACT.

It is submitted that this question is controlled by the decisions of the Supreme Court of the United States in the case of *Lynch vs. United States*, 292 U. S. 571, and *Perry vs. United States*, 294 U. S. 330.

The Lynch case involved certain provisions of the economy act of March 20, 1933, which, in effect, for the purpose of affecting economy in Government took away from the holders of Veterans War Risk Insurance, issued after the first war, certain rights and privileges given by the policies of insurance. The Court denied the power in the following language:

“The Fifth Amendment commands that property be not taken without making just compensation. Valid contracts are property, whether the obligor be a private individual, a municipality, a State or the United States. Rights against the United States arising out of a contract with it are protected by the Fifth Amendment. * * * When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals. That the contracts of war risk insurance were valid when made is not questioned. As Congress had the power to authorize the Bureau of War Risk Insurance to issue them, the due process clause prohibits the United States from annulling them, unless, indeed, the action taken falls within

the federal police power or some other paramount power.

“The Solicitor General does not suggest, either in brief or argument, that there were supervening conditions which authorized Congress to abrogate these contracts in the exercise of the police or any other power. The title of the Act of March 20, 1933, repels any such suggestion. Although popularly known as the Economy Act, it is entitled an ‘Act to maintain the credit of the United States.’ Punctilious fulfillment of contractual obligations is essential to the maintenance of the credit of public as well as private debtors. No doubt there was in March, 1933, great need of economy. In the administration of all government business economy had become urgent because of lessened revenues and the heavy obligations to be issued in the hope of relieving widespread distress. Congress was free to reduce gratuities deemed excessive. *But Congress was without power to reduce expenditures by abrogating contractual obligations of the United States.* To abrogate contracts, in the attempt to lessen government expenditure, would be not the practice of economy, but an act of repudiation. ‘The United States are as much bound by their contracts as are individuals. If they repudiate their obligations, it is as much repudiation, with all the wrong and reproach that term implies, as it would be if the repudiator had been a State or a municipality or a citizen.’ Sinking Fund Cases, 99 U. S. 700, 719, 25 L. ed. 496, 501.” (Italics ours.)

This question was re-examined by the Court in the so-called Gold cases decided in 1935. In 1935 Congress, at the suggestion of the administration, declared the existence of an emergency and further declared that any obligation which purported to give to the obligee

the right to require payment in gold or any particular kind of coin or currency obstructed the power of Congress to regulate the value of the money. The resolution then provided that any such obligation was declared to be against public policy and that every such obligation regardless of its contents should be discharged upon payment, dollar for dollar, in any coin or currency which was declared then to be legal tender. The resolution further declared that the term "obligation" meant every obligation of the United States except currency. The Court will find a full copy of this resolution set forth in *Norman vs. B & O Railroad Company*, 294 U. S. 240, 79 Law Ed. 893. The Court will remember that thereafter money was devalued under a general statute which permitted the President, by proclamation, to devalue the currency by changing the weight of the gold dollar, with a limitation that such devaluation should not be more than fifty per cent. By executive order then all gold was reclaimed by the Government and the possession of gold, except for certain purposes, was declared to be unlawful, and on January 31, 1934, the President fixed the weight of the gold dollar at a certain amount.

The legality of this resolution was challenged in two cases. The first case was *Norman vs. B & O Railroad*, supra. This involved certain railroad bonds issued before the passage of the resolution which provided that

principal and interest should be paid in gold coin equal to the standard of weight and fineness then existing. The Court held that as to transactions between private persons the resolution was valid. It is unnecessary to review the decision in detail. The Court simply held that when contracts were entered into between private individuals that these contracts were subject to the exercise of the police power by the Congress, or as stated by the Court "parties cannot remove their transactions from the range of dominant constitutional power by making contracts about them."

Perry vs. United States, 294 U. S. 330; 79 Law Ed. 913, was a case of a different character, however. In that case the plaintiff was the holder of a liberty bond which provided that "the principal and interest hereof are payable in United States Gold Coin of the present standard of value." The standard of value of course was much more than that fixed by the President under the joint resolution. The bondholder demanded currency in an amount exceeding the face of the bond in the same ratio as that borne by the number of grains in the former gold dollar to the number in the existing one. He was refused payment of more than the face of the bond in currency by the Treasurer. He then brought an action in the Court of Claims. The Court of Claims certified certain questions to the Supreme Court. The Court held (1) that the attempted repudia-

tion by the Government of the gold clause in the bond was an unconstitutional exercise of Congressional authority by the Congress and therefore invalid, and (2) that, however, all the plaintiff could recover would be his damage, and that since he was not able to show damage, he could not recover anything. We are not here concerned with the second point made because here the Government asks for a judgment. We are, however, very much concerned with the first point. The following extracts from the opinion are interesting:
On page 350 it was said:

“The Government’s contention thus raises a question of far greater importance than the particular claim of the plaintiff. On that reasoning, if the terms of the Government’s bond as to the standard of payment can be repudiated, it inevitably follows that the obligation as to the amount to be paid may also be repudiated. The contention necessarily imports that the Congress can disregard the obligations of the Government at its discretion and that, when the Government borrows money, the credit of the United States is an illusory pledge.

“We do not so read the Constitution. There is a clear distinction between the power of the Congress to control or interdict the contracts of private parties when they interfere with the exercise of its constitutional authority, and the power of the Congress to alter or repudiate the substance of its own engagements when it has borrowed money under the authority which the Constitution confers. In authorizing the Congress to borrow money, the Constitution empowers the Congress to fix the amount to be borrowed and the terms of payment. By virtue of the power to borrow money *‘on the*

credit of the United States' the Congress is authorized to pledge that credit as an assurance of payment as stipulated,—as the highest assurance the Government can give, its plighted faith. To say that the Congress may withdraw or ignore that pledge, is to assume that the Constitution contemplates a vain promise, a pledge having no other sanction than the pleasure and convenience of the pledgor. This Court has given no sanction to such a conception of the obligations of our Government." (Italics are the Court's.)

And again on page 353 the Court said:

"The powers conferred upon the Congress are harmonious. The Constitution gives to the Congress the power to borrow money on the credit of the United States, an unqualified power, a power vital to the Government—upon which in an extremity its very life may depend. The binding quality of the promise of the United States is of the essence of the credit which is so pledged. Having this power to authorize the issue of definite obligations for the payment of money borrowed, the Congress has not been vested with authority to alter or destroy those obligations. The fact that the United States may not be sued without its consent is a matter of procedure which does not affect the legal and binding character of its contracts. While the Congress is under no duty to provide remedies through the courts, the contractual obligation still exists and, despite infirmities of procedure, remains binding upon the conscience of the sovereign. *Lynch vs. United States*, supra. pp. 580, 582."

These cases then squarely hold that when the Government enters into a contract with a citizen, that Congress then has no power thereafter to repudiate that contract, either in whole or in part.

Reference to these two cases made in the Government's brief is upon page 15, where it is asserted that the Lynch case is distinguishable because it is said that case involved taking property without making just compensation, and the Perry case is distinguishable because it did not involve any war powers.

Insofar as the Lynch case is concerned, we submit that the distinction sought to be made is a distinction without a difference. The case does hold that where a valid contract is entered into with the Government that constitutes a vested property right which cannot thereafter be taken away without just compensation under the provisions of the Fifth Amendment. So here, when the Government entered into this contract with Bonnell to build certain barracks for the War Department (R. 3) for an agreed compensation, then likewise the Government had no right to thereafter seek to deprive Earley and Bonnell of a portion of the consideration which it had promised to pay Bonnell when the contract was entered into, and which it afterwards did pay.

Cases are cited, including *Spaulding vs. Douglas Aircraft Company*, 154 Fed. (2d) 419, to the effect that a statute may be retroactive in its features and an analogy is sought to be drawn between retroactive taxation and the question here involved. Insofar as the renegotiation of contracts entered into between private individuals is concerned, it may be admitted that

the right has been established. Whatever may be the logical difference between such a contract and a prime contract with the Government, the fact remains that the Supreme Court of the United States in the Lynch and Perry cases has distinctly denied the power of the Congress to repudiate the contractual commitments of the Government. These decisions are binding upon this Court unless and until they are overruled by the United States Supreme Court.

The suggestion that the cases may be differentiated because this act was in exercise of the war power is not supported by the citation of any authority and we have found none. It is true that in certain instances it has been held that there may be a temporary abrogation of certain rights, such as a declaration of martial law and the temporary suspension of Writs of Habeas Corpus, or the temporary control of rents. We have not found, however, any decision which holds that the provisions of the Fifth Amendment become ineffective upon the happening of a war.

The oldest and most widely cited case is the famous case of *Ex parte Milligan*, 4 Wall (2), 18 Law Ed. 281, where the supremacy of the Constitution was sustained against the claim of military authorities of the right to try a civilian by court martial in time of war. We quote from the case:

“The Constitution of the United States is a law for rulers and people, equally in war and in peace, and covers with the shield of its protection all classes of men, at all times, and under all circumstances. No doctrine involving more pernicious consequences was ever invented by the wit of man than that any of its provisions can be suspended during any of the great exigencies of government. Such a doctrine leads directly to anarchy or despotism, but the theory of necessity on which it is based is false; for the government, within the Constitution, has all the powers granted to it which are necessary to preserve its existence, as has been happily proven by the result of the great effort to throw off its authority.”

Hamilton vs. Kentucky Distilleries & W. Co., 251 U. S. 146; 64 Law Ed. 194, was a case in which the Court sustained an Act of Congress which prohibited, until the declaration of peace in the first war, the sale of intoxicating liquors to the military personnel or the removal of bonded liquor for sale, except for export. The Act was sustained upon the theory that “there was no appropriation of the liquor for public purposes” and it was pointed out that the law gave a period of time in which it could be disposed of. The opinion which was written by the late Justice Brandeis, a famous Judge who had a most liberal view of the Constitution, however, stated that “*the war power of the United States, like its other powers, and like the police power of the states, is subject to applicable constitutional limitations.*”

In *Ludecke vs. Watkins*, 335 U. S. 160; 92 Law Ed. 1881, the Court held that the Constitution was not offended by statute which permitted, without a previous hearing, the removal of an alien enemy. Judge Douglas dissented from the basic conclusion but the following statement made in the dissenting opinion is not contradicted by the majority opinion:

“It is well established that the war power does not remove Constitutional limitations safeguarding essential liberties.”

In *Woods vs. Miller*, 333 U. S. 138; 92 Law Ed. 596, the Court sustained the continuance of the National Rent Control law after the cessation of hostilities but very carefully points out in rather general language that no property was taken without just compensation. Even the majority opinion, however, citing *Hamilton vs. Kentucky Distilleries & W. Co.* supra, states that “the question whether the war power has been properly employed in cases such as this is open to judicial inquiry.” The concurring opinion of Mr. Justice Frankfurter states that he concurred “in this opinion because it decides no more than was decided in *Hamilton vs. Kentucky Distilleries & W. Co.*”

Mr. Justice Jackson, concurring, said in part:

“I agree with the result in the case, but the arguments that have been addressed to us lead me to utter more explicit misgivings about war powers

than the Court has done. The Government asserts no constitutional basis for this legislation other than this vague, undefined and undefinable 'war power.'

"No one will question that this power is the most dangerous one to free government in the whole catalogue of powers. It is executed in a time of patriotic fervor that makes moderation unpopular. And, worst of all, it is interpreted by the Judges under the influence of the same passions and pressures. Always, as in this case, the Government urges hasty decision to forestall some emergency or serve some purpose and pleads that paralysis will result if its claims to power are denied or their confirmation delayed."

In *Bowles vs. Willingham*, 321 U. S. 503; 88 Law Ed. 892, the Court sustained the original Rent Control Law as doing nothing more than regulating rental transactions in order to take care of a war emergency and thus within the war power. This case, however, clearly recognizes that even war does not justify the taking of property without just compensation because it was there said:

"We fully recognize, as did the Court in *Home Bldg. & Loan Assoc. vs. Blaisdell*, 290 U. S. 398-426; 78 Law Ed. 413-422; 54 S Ct. 231; 99 ALR 1481, that 'even the war power does not remove constitutional limitations safeguarding essential liberties.' "

In apparent recognition of the fact that the distinction sought to be drawn between this case and the *Lynch* and *Perry* cases are not logical, it is claimed that

the Supreme Court of the United States in *Lichter vs. United States*, 334 U. S. 742, and *Lincoln Electric Company vs. Forrester*, 334 U. S. 841, has decided the question.

We submit that upon the contrary the question now presented was expressly reserved by the Supreme Court in those cases. The *Lichter* case involved three consolidated appeals from decisions of the Fifth, Sixth and Ninth Circuits in cases involving the renegotiation of profits which had been received on Government contracts. As is pointed out on page 788 of the decision, all of the contracts involved were made after the passage of the Renegotiation Act, except four in the *Lichter* case, but those four contracts were contracts between private contractors and subcontractors and were not contracts with the United States. Substantially all of the opinion is devoted to a discussion of the question of whether the act unlawfully delegated legislative powers to the administrative branch of the Government, and whether an amendment made to the act providing for a review by the Tax Court lacked in due process.

It was not contended, and indeed it could not have been, that it was not within the general power of the Congress to provide that all contracts thereafter made with the Government should be subject to renegotiation. Such a provision of statute would of course be regarded

as incorporated in the contract by reference, even if not expressly placed therein. As to subcontractors, clearly under the decision in *Norman vs. B & O Railroad*, supra, the act was effective, since as to those contracts the pledge of the Government had not been given. This, as we have shown, was the only type of contract entered into previous to the passage of the act involved in the case. The decision makes no reference whatsoever to either the Perry or the Lynch cases and, as we read it, very carefully avoids passing upon this question. Since the portion of the opinion which has to do with this is short, we reproduce it in full:

“The excessive profits claimed by the Government in these cases arose out of contracts between the respective petitioners and other private parties. *None arose out of contracts made directly with the Government itself.* All the contracts, however, related to subject matter within the meaning of the Renegotiation Act in its respective states. The contracts all were of the type which came to be known, under the Act, as subcontracts. All, except four in the Lichter case, were entered into after the enactment of the Original Renegotiation Act, April 28, 1942, and on those four, the final payment had not been made by that date. *We therefore do not have before us an issue as to the recovery of excessive profits on any contract made directly with the Government nor on any subcontract upon which final payment had been made before April 28, 1942,* although relating to war goods made or services performed after the declaration of War, December 7, 1941. Congress limited the Renegotiation Act to future contracts and to contracts already existing but upon which final payments had not been made

at the time of the passage of the original act. These included contracts made directly with the Government and also subcontracts such as those here involved.

“We uphold the right of the Government to recover excessive profits *on each of the contracts before us*. This right exists as to such excessive profits whether they arose from contracts made before or after the passage of the Act. A contract is equally a war contract in either event and, if uncompleted to the extent that the final payment has not yet been made, the recovery of excessive profits derived from it may be authorized as has been done here.” (*Italics ours.*)

We call the particular attention of the Court to the fact that the opinion specifically points out that none of the contracts involved in the case which were entered into previous to the passage of the Act, were made directly with the Government. Of particular significance is the statement of the Court that “we uphold the right of the Government to recover excessive profits *on each of the contracts before us*.” The contracts before the Court were not contracts with the Government. If the Court had intended to overrule or distinguish the Lynch and Perry cases, then certainly they would have been referred to.

The suggestion upon page 12 of the Government’s brief that *Lincoln Electric Company vs. Forrestal* in some way decided the point expressly reserved in the Lichter case is not supported by the reported deci-

sion of that case. The decision is a *per curiam* decision which affirms the judgment of the Court below on the authority of the Lichter case. It seems rather obvious, that in view of the careful reservation of the question in the Lichter case, that it should not be presumed that the Supreme Court intended in this *per curiam* opinion to decide the very question which it had previously reserved. A reference to the opinion of the Court below in the Lincoln Electric Company case, 77 Fed. Sup. 441, shows that this was a proceeding for a declaratory judgment. There is nothing in the opinion to show that there was involved in the case any prime contract entered into before the taking effect of the Act. Certainly the stated fact that the period involved was the year 1942 does not justify the assertion that the case is applicable, because the Act became effective on April 28, 1942, and any contracts entered into thereafter even if directly with the government would, under the Lichter case, be subject to renegotiation. We can find nowhere in the decision of the lower Court any statement of fact or any statement of contentions made which show that the point which we are now presenting was either involved or decided.

NO INTEREST SHOULD HAVE BEEN ALLOWED

As is conceded in the brief of the Government, there is no provision providing for the imposition of

interest either in the Renegotiation Act or in any general statute. It may be conceded that the various District and Circuit Courts including this Court have held in *cases involving contracts entered into after the passage of the Act*, that the refusal of a contractor to pay an amount legally determined to be due the Government permits the imposition of interest until the amount is paid. The decision of this court in the case of *Sampson Motors, Inc. vs. United States*, 168 Fed. (2nd) 871, so holds. This decision is based upon the case of *United States vs. Strontium Products Co.*, 68 Fed. Supp. 886, from which a long quotation is set forth. That case involved the renegotiation of a contract made after the taking effect of the Act and it was held that although the act made no express provision for the payment of interest, that in view of the fact that the Act was in existence at the time the contract was made that the provision for renegotiation must be considered to be by implication a part of the contract. We quote from the decision :

“In view of the above, I conclude that all war contracts made by defendants with plaintiff during 1943 must be considered as containing the agreement for elimination of excess profits by renegotiation, and therefore that defendants’ liability is based upon express contract.”

Here it cannot be contended that Bonnell’s agreement with the Government should be considered as

containing by implication an agreement to renegotiate, because when the agreement was made there was no such statute. The Strontium case, *supra*, which is the basis of this Court's decision in the Sampson case, says that "this is not a suit between private individuals but one brought by the Government seeking to recover a *debt, ex contractu*, from private persons. The allowance of interest in such a situation does not require an express statutory authority." This quotation is set forth in the decision of this Court. Certainly in the case at bar the right to renegotiate cannot be sustained upon the theory that there was a contract, either express or implied, to pay negotiated excess profits. No authorities are cited in the brief to sustain the proposition that a Government claim not based on contract but on the exercise of the police power permits the imposition of interest.

THERE IS NO EVIDENCE TO SHOW THAT THE DISTRICT COURT ABUSED ITS DISCRETION WHEN IT FIXED THE INTEREST RATE AT 3%.

As we have shown, this was in the discretion of the District Court, since there was no statute which either commanded the imposition of interest or fixed the rate. No evidence was taken on the question since the judgment entered was the result of the granting by the Court of the Government's Motion for Judg-

ment on the Pleadings. The motion therefore conceded the truth of the allegations of the defendants partial defense which was addressed only to the question of the interest rate (R. 25 to 30). An examination of the Answer therefore becomes necessary. Paragraph 1 of the Answer alleges that the contract here involved was for the construction of certain barracks shortly after the beginning of the last war; that the contract required completion of the work within sixty days "and involved much hazard and risk of loss arising out of the then uncertainty with respect to securing lumber and adequate labor." It is further alleged that Earley had been for many years engaged in the contracting business and that in 1942 he took war contracts in a substantial sum. It was further alleged that he was renegotiated by the Government for this other business "and it was found and determined that he made no excessive profits and he was not required to repay to the Government any sum whatsoever upon said contracts." It was also alleged that during this time "it was almost the universal practice of the Government to renegotiate these contracts on an annual basis."

Paragraph 2 alleges that during this time the ordinary commercial rate of interest in the area ranged from $3\frac{1}{2}\%$ to $4\frac{1}{2}\%$ even if on open and unsecured loans, and that during the same period the Government paid interest ranging from 1% on short term loans to a maximum of 2.9% on treasury bonds.

Paragraph 3 contains a long recital of the transactions between the defendants and the Government which it is important to consider. It recites that on June 20, 1946, defendants' attorneys received a letter from the Assistant District Attorney advising that he had been instructed by the Attorney General of the United States "to undertake settlement of the above matter" (R. 27). We think it cannot be denied that previous to that time the defendants had refused to make any payment based upon the Constitutional objection heretofore made. The paragraph further recites that there was some discussion between these attorneys and the Asst. District Attorney which culminated in the submission by defendants' counsel to the District Attorney's office of an offer of compromise and settlement. This offer was forwarded by the District Attorney to the Attorney General of the United States and thereafter the District Attorney was advised by the office of the Attorney General that "it is suggested that you have the contractors' attorneys make a similar written offer of compromise settlement addressed to the Attorney General." (R. 27). The paragraph further alleges that pursuant to this suggestion the defendants on December 20, 1946, submitted to the Attorney General an offer of compromise and settlement and that on January 13, 1947, an Asst. Attorney General sent to defendants' attorneys a letter which is

copied in full (R. 28). This letter acknowledges receipt of the compromise offer and states that the practice in such matters is to, among other things, get the views of the United States Attorney handling the case and then concludes "we are now awaiting the views of the United States Attorney at Seattle, Washington. As soon as we hear from him you will be advised of the Department's final position in the matter." The Answer further states that at that time several cases were pending in the Federal Courts involving the validity of the Act and the allegation was made on information and belief "that no action was taken on defendants offer of compromise pending the determination of certain cases then pending in the Federal Courts." It was further alleged that Mr. Sonnett, the author of the letter of January 13th, never did advise defendants' counsel "of the Department's final position in the matter," but that on June 1, 1948, which was almost two years after the original letter from the Attorney General's office directing the District Attorney to make a settlement, the defendants were advised that the compromise proposal made under date of December 20, 1946, had been finally rejected.

From this review of the Answer, the truth of which is admitted, it is submitted that there appears at least three reasons which justify the refusal of the District Court to allow the maximum rate demanded.

The first reason arises out of a rather unusual situation with respect to Earley. The original Renegotiation Act allowed the Government to renegotiate either upon an annual basis, that is to say, upon the basis of the entire profits made by the contractor in a year, or to renegotiate individual contracts without regard to the profits, if any, obtained by the same contractor from other war contracts during the same year. Insofar as this contract was concerned Earley received 50% of the profits in 1942 and the joint adventure then came to an end. The Motion for Judgment, however, admits our allegation that during the same year Earley received substantial sums from other Government contracts and that he was renegotiated and nothing further was found due to the Government therefrom. Had his 50% share of this particular venture been included in this annual renegotiation, it is doubtful whether anything would have been found due from him. Certainly it would not have been the amount here sought to be recovered and certainly this fact placed him in a different position than contractors who had been renegotiated for their entire annual profits and ordered to return a portion as excessive. Although this is outside the record, we might state that in the offer to compromise we waived the Constitutional objection and offered to pay one-half of the renegotiated sum, being the one-half Bonnell would have had to pay. The injus-

tice of a renegotiation conducted as this one was is obvious even though there might have been no legal defense to it. It permitted the Government to renegotiate and recapture profits received on a single contract by a contractor who had other contracts with the Government upon which he might have lost money, or at least made no other profits. Indeed this was the exact situation here insofar as Earley was concerned. The possibility of this injustice was recognized by Congress and the Act was amended in the fall of 1942 by a provision which required renegotiation to be conducted on an annual basis, unless the contractor consented to a different procedure. (Act of Oct. 21, 1942, 50 U.S.C.A. War Appendix Sec. 1191 (c) (1).)

This case is unique in that it is the only adjudicated case which we have been able to find where the renegotiation was not made on an annual basis. Earley was unfortunate in that he entered into this transaction prior to the October amendment. While it is true, assuming the Act to be valid, that he had no legal defense to the Government's election to treat him unfairly by refusing to include in the overall renegotiation his one-half of the profits from this deal, it would still seem that the District Court had the right to consider this in connection with the exercise of his discretion when he fixed the interest rate.

The second reason in support of the District Court's conclusion is the conceded fact that at that time the interest on commercial loans ranged from $3\frac{1}{2}\%$ to $4\frac{1}{2}\%$ although not secured, and that the rate paid by the Government on Government bonds ranged from 1% to 2.9% . Having in mind the circumstances which we have related, was it just and equitable for a Government which paid as little as 1% for loans made to it to demand 6% in this instance.

The third reason arises out of the negotiations, which occupied some two years, between defendants' counsel and the office of the Attorney General of the United States. Instead of filing an action in June, 1946, to enforce its claim, the Government itself proposed that an offer of compromise be made and then when the offer was made it was permitted to remain upon the desk of some person in the Attorney General's office for a period of about seventeen months despite the promise made by the Asst. Attorney General that as soon as the views of the District Attorney had been secured defendants "would be advised of the Department's final position in the matter." It is conceded that the reason for this was that the office of the Attorney General was awaiting the decision of some other cases then pending in the Federal Courts. (R. 29.) The defendants of course were powerless to do anything since the Government was the prospective plaintiff in

the action, but had started no action. Doubtless it was felt that if the matter was then pressed it was possible that an adverse decision might be made by the Court below which would perhaps affect other renegotiations from the standpoint of the Government. We do not here contest the right of the Asst. Attorney General, for reasons deemed sufficient by him, to postpone action on this claim, nor, we suppose, was he legally obligated to carry out the promise made in the January letter, whatever one may think of his seeming lack of courtesy. Be that as it may, however, this delay of two years in the final prosecution of this claim was not made at our request and occurred on account of the action of the Government. It seems clear, therefore, that this was a circumstance which justified the District Court in exercising his discretion in the manner in which he did, because had the Government proceeded with reasonable diligence two years' interest would have been eliminated.

The District Court expressly considered the last two reasons which we have suggested, but made no reference to the first one (R. 37-38). It is also significant that at the hearing the trial Court observed that with respect to the delay "the Government agrees it is at least as culpable as the defendant in this case" (R. 38). To this statement the only rejoinder made by Government counsel was that the Government "never dis-

couraged the defendant from making further offers.” We also direct attention to the Court’s ultimate finding on this contained on page 38 in which he says “I shall find that the interest in this particular case, *under the facts as admitted by the oral arguments and by the pleadings*, should be at the rate of 3% instead of 6%.” The oral arguments are not contained in the record but it does appear from the Court’s decision that the Government admitted that the delay in the prosecution of the case was caused by its own action.

Can it be said that the District Court abused its discretion when it refused to fix a maximum rate of interest in view of all these circumstances? We submit not.

It is suggested that there was nothing to prevent the payment of the claim during the period of this delay. In answer to this we suggest that certainly the defendants were justified in withholding payment in view of the invitation of the Government to submit a compromise offer with the promise of the Government that the matter would be soon determined.

On pages 33 and 34 attention is called to two or three decisions of the lower Federal Courts where a rate of 6% was allowed. No facts or circumstances appear in any of these cases of the nature here involved. Each of them involve the flat refusal of the

contractor to pay based upon Constitutional grounds, or perhaps in some instances upon questions of fact, where no appeal had been taken to the Tax Court. In two cases, however, Federal District Courts have fixed a lower rate than 6%. In *U. S. vs. Clark*, 72 Fed. Supp. 393, Judge McColloch of the Oregon District Court fixed an interest rate of $2\frac{1}{2}\%$ on a renegotiation judgment. Apparently in that case there were no extenuating factors as here. The judgment in the case was for some \$42,000.00. Some curiosity might be expressed as to why no appeal was taken from that judgment by the Attorney General.

In *United States vs. United Drill & Tool Corporation*, 81 Fed. Supp. 171, the question was passed on by District Judge Holtzoff of the United States District Court of the District of Columbia, which was after the decision of this Court in the Sampson case. The Court there concluded that since the Court of Claims in *Arkansas Valley Railroad vs. United States*, 68 Fed. Supp. 727, had sustained the position of the Government that, in the absence of statute, 4% was the proper rate to be applied in a judgment against the United States, that the same rate would be there allowed. In that case also there appear to have been no extenuating circumstances. It might also be noted that the Court concludes, following the reasoning of the Court of Claims, "that an approach to the market rate of inter-

est was the proper measure of damage rather than using the analogy of statutory interest.” We also call attention to the statement in that case to the effect that “the purpose of interest is to award damages for delay in the payment of money, unless interest is expressly provided by contract or statute.” If such be the purpose here, then certainly we should not be charged with the two years’ delay for which the Government was responsible.

This case was decided November 23, 1948, and the citator does not reveal that the Government attempted to appeal to a higher Court. Curiosity is again expressed as to why an appeal was not taken from that case. It may be that the justified criticism by the Court below of the lack of diligence on the part of the office of the Attorney General caused that office to prosecute this appeal rather than the importance of the question or amount of money involved.

Pages 35 and 36 lend some credence to this thought, since complaint is made here that the sum of \$307.73 required to be credited on the amount of the Government’s claim was credited to principal rather than interest to the detriment of the Government. The brief does not compute the detriment, if any, which the Government would sustain. Conceding that it is right, for the purpose of the argument, it could not possibly

amount to more than a few dollars. The matter is certainly not of sufficient importance to call for the consideration of an appellate Court. But in any event, as we have previously pointed out, the judgment was prepared by counsel for the Government and the Court made no direction whatsoever concerning the manner of applying the additional credit. If there was error, it was invited error for which the Government was responsible and it is therefore now estopped from questioning the item.

Respectfully submitted,

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Roy T. Earley.*

No. 12307

IN THE
United States
Court of Appeals
FOR THE NINTH CIRCUIT

EARL W. TAYLOR,

Petitioner-Appellant,

vs.

P. J. SQUIER, Warden, United States
Penitentiary, McNeil Island, Washington,
Respondent-Appellee.

ON APPEAL FROM THE DISTRICT COURT OF THE UNITED
STATES FOR THE WESTERN DISTRICT OF WASHINGTON,
SOUTHERN DIVISION.

HONORABLE CHARLES H. LEAVY, *Judge*

BRIEF OF APPELLEE

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No. 12307

IN THE
United States
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EARL W. TAYLOR,

Petitioner-Appellant,

VS.

P. J. SQUIER, Warden, United States
Penitentiary, McNeil Island, Washington,
Respondent-Appellee.

ON APPEAL FROM THE DISTRICT COURT OF THE UNITED
STATES FOR THE WESTERN DISTRICT OF WASHINGTON,
SOUTHERN DIVISION.

HONORABLE CHARLES H. LEAVY, *Judge*

BRIEF OF APPELLEE

J. CHARLES DENNIS,
United States Attorney

GUY A. B. DOVELL,
Assistant United States Attorney
Attorneys for Appellee

OFFICE AND POST OFFICE ADDRESS:
324 FEDERAL BUILDING
TACOMA 2, WASHINGTON

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No. 12307

IN THE
United States
Court of Appeals
FOR THE NINTH CIRCUIT

EARL W. TAYLOR,

Petitioner-Appellant,

vs.

P. J. SQUIER, Warden, United States
Penitentiary, McNeil Island, Washington,
Respondent-Appellee.

ON APPEAL FROM THE DISTRICT COURT OF THE UNITED
STATES FOR THE WESTERN DISTRICT OF WASHINGTON,
SOUTHERN DIVISION.

HONORABLE CHARLES H. LEAVY, *Judge*

BRIEF OF APPELLEE

STATEMENT OF PLEADINGS AND FACTS

Appellant on May 20, 1949, filed in the United States District Court of the Western District of Washington, Southern Division, his petition for a writ of habeas corpus, praying to be released from his alleged premature imprisonment on McNeil Island, for the

alleged reason and upon the alleged grounds that such premature imprisonment interfered and denied to him the free exercise of his right to prosecute his timely and yet undetermined appeal from his conviction in the United States District Court for the Northern District of California, Southern Division, wherein are his witnesses, evidence, records and other proofs, as well as his law books and briefs, such curtailment in his opinion amounting to a denial of due process and contrary to and in violation of the fifth amendment to the United States Constitution. (Tr. 1 - 4).

Thereafter, the District Court having determined the issue to be one of law, and not of fact (Tr. 6), and that the same should be resolved against the appellant, on its own motion, entered an order denying appellant's petition and dismissing the action. (Tr. 5 - 7). From that final order the appellant has been permitted to appeal. (Tr. 8 - 17).

The facts material to a determination of appellant's right to discharge from present confinement, as disclosed in the record, may be summarized as follows:

Appellant was sentenced in the United States District Court for the Northern District of California, Southern Division, and thereafter on April 25, 1949, filed his appeal in that court, which is now pending,

not having been ruled on as yet. That on April 27, 1949, he was committed to the United States Penitentiary at McNeil Island, Washington, where he is now confined pursuant to said judgment and commitment. (Tr. 1 - 3). The record is devoid of any allegation or showing upon the matter of an election to, or not to commence service of sentence.

QUESTION PRESENTED

Does an appeal, filed April 25, 1949, from a conviction in a federal court and sentence to a penitentiary, stay execution of such sentence in the absence of an election not to commence service or admission to bail?

ARGUMENT AND AUTHORITIES

The law involved in this proceeding is found in Rule 38 of Federal Rules of Criminal Procedure following Sec. 687, Title 18, U. S. Code, the pertinent portion of which reads as follows:

Rule 38, Stay of Execution, and Relief Pending Review.

(a) *Stay of Execution.*

* * * *

(2) *Imprisonment.* A sentence of imprisonment shall be stayed if an appeal is taken and the defendant elects not to commence

service of the sentence or is admitted to bail.

The effective date of the foregoing rule is March 21, 1946, and this rule was in effect at the time of the judgment and sentence.

See *Tilghman v. Hunter*, 168 F. (2d) 946.

Appellant seeks to bring his case under the terms of the former Rule 5, Rules of Criminal Procedure, because he alleges that the crime for which he was convicted occurred in February, 1946, and that he is subject to the rules and laws in effect at the time of the commission of the crime. (App. Brief 3). This, appellant assumes to be true whether it relates to substantive rights or to matters of procedure effective at time of sentence, but not at time of commission of crime.

See *Baker v. Hunter*, 142 F. (2d) 615.

Rule 38 *supra*, has shifted the burden of proof where it justly belongs. Too many petitioners, as the reported decisions disclose, have later laid claim to time served in jail pending appeal, because it was incumbent upon the government to disprove the claim later made by the petitioners that they had once upon a time notified some obscure jailer that they elected to commence service.

Flynn v. Squier, Cause No. 747, United States District Court, Western District of Washington, Southern Division, decided February 15, 1945, unreported.

See Contra, *Demarois v. Hudspeth*, 99 F. (2d) 274, where the court refused to allow petitioner credit for time in jail. It is appellee's contention that former Rule 5 deserves to be neither re-invoked nor reinstated.

CONCLUSION

For the foregoing reasons, we contend the decision below should be affirmed.

Respectfully submitted,

J. CHARLES DENNIS,
United States Attorney

GUY A. B. DOVELL,
Assistant United States Attorney
Attorneys for Appellee.

No. 12308

United States
Court of Appeals
For the Ninth Circuit.

EDDY D. FIELD and HELEN FIELD,
Petitioners,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of Record

Upon Petition to Review a Decision of the Tax Court
of the United States

FILED

NOV 5 - 1940

FAUL P. O'BRIEN,
CLERK

No. 12308

United States
Court of Appeals
For the Ninth Circuit.

EDDY D. FIELD and HELEN FIELD,
Petitioners,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of Record

Upon Petition to Review a Decision of the Tax Court
of the United States

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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The Tax Court of the United States

Docket No. 13721

EDDY D. FIELD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Appearances:

For Petitioner:

GEORGE BOUCHARD.

For Respondent:

A. J. HURLEY,

R. C. WHITLEY.

DOCKET ENTRIES

1947

Apr. 29—Petition received and filed. Taxpayer notified. Fee paid.

Apr. 30—Copy of petition served on General Counsel.

June 3—Answer filed by General Counsel.

June 3—Request for hearing at Los Angeles, Calif., filed by General Counsel.

June 6—Notice issued placing proceeding on Los Angeles calendar. Service of answer and request made.

1948

Feb. 13—Hearing set 4/26/48, Los Angeles, Calif.

- Apr. 26—Hearing had before Judge Arnold on petitioner's motion for continuance to next Los Angeles calendar granted.
- Apr. 26—Order that this proceeding is continued to the next Los Angeles calendar entered.
- July 28—Hearing set Oct. 11, 1948, Los Angeles, California.
- Oct. 19—Hearing had before Judge Arundell on merits. Oral motion for parties, proceedings consolidated for hearing in dkts. 13721-13722. Briefs due 12/3/48; replies Dec. 23, 1948.
- Nov. 4—Transcript of hearing 10/19/48 filed.
- Nov. 24—Motion to reopen proceedings to admit in evidence petitioner's 1944 income tax return filed by General Counsel.
- Nov 24—Objection to motion to open record filed by taxpayer.
- Nov. 24—Respondent's motion denied.
- Nov. 26—Motion for extension to Dec. 31, 1948, to file brief filed by taxpayer. 11/26/48. Granted.
- Nov. 29—Motion for extension to Jan. 3, 1949, to file briefs filed by General Counsel. 12/1/48. Granted.
- Dec. 20—Motion for extension to Jan. 20, 1949, to file brief filed by taxpayer. 12/21/48. Granted.

1949

- Jan. 3—Brief filed by General Counsel.
- Jan. 17—Brief filed by taxpayer. 1/18/49 Copy served.
- Feb. 11—Reply brief filed by taxpayer. 2/14/49 Copy served.
- Feb. 23—Memorandum findings of fact and opinion rendered, Judge Arundell. Decision will be entered under Rule 50. Copy served.
- Apr. 5—Respondent's computation filed.
- Apr. 8—Hearing set May 4, 1949, on respondent's computation.
- May 4—Hearing had before Judge Turner on settlement. Referred to Judge Arundell.
- May 4—Decision entered, Judge Arundell, Div. 7.
- July 1—Petition for review by U. S. Court of Appeals, Ninth Circuit filed by taxpayer.
- July 1—Designation of contents of record filed by taxpayer.
- July 1—Affidavit of service by mail of petition for review and designation of contents of record on General Counsel filed by taxpayer.

The Tax Court of the United States
Docket No. 13722

HELEN FIELD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Appearances:

For Petitioner:

GEORGE BOUCHARD.

For Respondent:

A. J. HURLEY,

R. C. WHITLEY.

DOCKET ENTRIES

1947

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1948

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Granted.

1949

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Jan. 17—Brief filed by taxpayer. 1/18/49 Copy served.

Feb. 11—Reply brief filed by taxpayer. 2/14/49
Copy served.

Feb. 23—Memorandum findings of fact and opinion rendered, Judge Arundell. Decision will be entered under Rule 50. Copy served.

Apr. 5—Respondent's computation filed.

Apr. 8—Hearing set May 4, 1949, on respondent's computation.

May 4—Hearing had before Judge Turner on settlement. Referred to Judge Arundell.

May 4—Decision entered, Judge Arundell, Div. 7.

July 1—Petition for review by U. S. Court of Appeals, Ninth Circuit, filed by taxpayer.

July 1—Designation of contents of record filed by taxpayer.

July 1—Affidavit of service by mail of petition for review and designation of contents of record on General Counsel filed by taxpayer.

The Tax Court of the United States

Docket No. 13721

EDDY D. FIELD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency dated February 25, 1947 (LA:IT:90D:LES) and, as a basis of his proceeding, alleges as follows:

First: Petitioner is a resident of Los Angeles, Los Angeles County, California.

Second: The notice of deficiency (copy of which is attached hereto and made a part hereof as Exhibit "A") was mailed to petitioner on or about February 25, 1947.

Third: The taxes in controversy are Income and Victory taxes for the taxable year ending December 31, 1943, in the amount of \$7,913.65.

Fourth: The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner erred in determining that said properties sold by petitioner in 1942 and 1943 were not capital assets within the meaning of Section 117 (a) (1) of the Internal Revenue Code,

and in determining that the gains from the sale or exchange of these properties are fully taxable as business income.

Fifth: The facts upon which petitioner relies, as a basis for this proceeding, are as follows:

(a) Petitioner has for several years last past been a licensed Real Estate Broker under the laws of the State of California; his principal income during said years being commissions realized from the sale of property belonging to others, commissions received for property management and commissions earned in the sale of insurance. The properties in question were owned by petitioner and his wife, Helen Field, as community property and the taxable profit upon their sale was reported one-half by petitioner, and one-half by petitioner's wife. The properties in question were purchased by petitioner and his wife as investment properties. They were not properties held by petitioner primarily for sale to customers in the ordinary course of his trade or business, or properties of a kind excepted from the definition of "Capital Assets" contained in Section 117 (a) (1) of the Internal Revenue Code. They were investment properties held by the petitioner, and the profit upon their sale or exchange was properly reported by him as capital gains.

(b) In so far as the Commissioner, in determining petitioner's 1943 tax liability, increased the same by virtue of increasing the tax liability shown due on petitioner's 1942 income tax return, the same is erroneous because a redetermination thereof on

said 1942 liability is barred by Section 275 (a) of the Internal Revenue Code.

Wherefore, petitioner prays that this Court may hear and determine:

(a) That the real property sold by petitioner in each of the years 1942 and 1943 were Capital Assets and subject to tax as such.

(b) That the statute of limitations has barred respondent's right to increase the tax liability as shown by his return filed for the year 1942.

/s/ EDDY D. FIELD,

Petitioner.

/s/ GEORGE BOUCHARD,

Counsel for Petitioner.

State of California,

County of Los Angeles—ss.

Eddy D. Field, being first duly sworn, on oath says:

That he is the petitioner herein; that he has read the foregoing Petition and is familiar with the statements contained therein and the facts stated therein are true, except as to those facts stated on information and belief, and those facts he believes to be true.

/s/ EDDY D. FIELD.

Subscribed and sworn to before me this 25th day of April, 1947.

[Seal] /s/ MARY E. McKNIGHT,

Notary Public in and for Said
County and State.

My Commission Expires 8/5/48.

EXHIBIT "A"

Treasury Department
Internal Revenue Service
417 South Hill Street
Los Angeles 13, California

Office of Internal Revenue Agent in Charge
Los Angeles Division, LA:IT:90D:LES

Feb. 25, 1947.

Mr. Eddy D. Field
940 South La Brea Avenue
Los Angeles 35, California

Dear Mr. Field:

You are advised that the determination of your income and victory tax liability for the taxable year ended December 31, 1943, discloses a deficiency of \$7,913.65, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA:Conf.

The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,
JOSEPH D. NUNAN, JR.,
Commissioner.

By /s/ GEORGE D. MARTIN,
Internal Revenue Agent in
Charge.

Enclosures:

Statement

Form of waiver

Statement

LA:IT:90D:LES

Mr. Eddy D. Field
940 South La Brea Avenue
Los Angeles 35, California

Tax Liability for the Taxable Year
Ended December 31, 1943

Income and victory tax

Deficiency, \$7,913.65

In making this determination of your income and victory tax liability careful consideration has been given to the report of examination dated January 27, 1947.

The properties sold in 1942 and 1943 from which you reported net capital gains in the amounts of \$3,607.19 and \$29,239.73 respectively are not capital assets within the meaning of section 117 (a) (1) of the Internal Revenue Code, and the gains from the sale or exchange of the properties reported in 1942 and 1943 are fully taxable as business income. The net capital gains reported have been adjusted to reflect their proper status as business income.

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1942

Net income as disclosed by return (before community property division of income).....		\$22,930.88
Unallowable deductions and additional income:		
(a) Rent	\$ 30.00	
(b) Income from business.....	5,804.18	
(c) Auto expense	295.70	
(d) Travel and entertainment expense....	13.14	6,143.02
		<hr/>
Total		\$29,073.90
Nontaxable income and additional deductions:		
(e) Net gain from sale or exchange of capital assets	\$3,607.19	
(f) Gardening supplies .....	.40	3,607.59
		<hr/>
Net income adjusted (before community property division)		\$25,466.31
Your community share (1/2 of \$25,466.31).....		\$12,733.16

EXPLANATION OF ADJUSTMENTS

(a) You deducted as a charge to outside rental commissions, the amount of \$30.00, which is disallowed due to lack of substantiation.

(b) The amount of gain from the sale of property, \$5,804.18, is taxable in full as business income, as previously explained.

(c) and (d) Auto expense, (\$295.70), and travel and entertainment expense, (\$13.14), deducted in excess of the amounts shown by your books of account and not substantiated are disallowed.

(e) The net capital gain reported in the amount of \$3,607.19 is eliminated, as such, from income and included as business income under item (b) above.

(f) Gardening supplies as shown by your books of account amounted to \$7.83, whereas you claimed as a deduction on your return \$7.43. The difference of .40 cents is allowed as a deduction.

COMPUTATION OF TAX

Taxable Year Ended December 31, 1942

Net income adjusted.....		\$12,733.16
Less: Personal exemption	\$ 250.00	
Credit for dependents.....	700.00	950.00
		<hr/>
Balance (surtax net income).....		\$11,783.16
Less: Earned income credit (10% of \$12,733.16).....		1,273.32
		<hr/>
Net income subject to normal tax.....		\$10,509.84
Normal tax at 6% on \$10,509.84.....	\$ 630.59	
Surtax on 11,783.16.....	2,590.61	
		<hr/>
Total normal tax and surtax.....	\$ 3,221.20	
Total income tax.....	\$ 3,221.20	
Correct income tax liability.....	\$ 3,221.20	

ADJUSTMENT TO NET INCOME

Taxable Year Ended December 31, 1943

	Income Tax Net Income	Victory Tax Net Income
Net income as disclosed by return (before community property division of in- come)	\$ 59,651.56	\$31,774.75
Unallowable deductions and additional in- come:		
(a) Income from business.....	50,894.64	50,894.64
(b) Short-term capital loss.....	576.11	
	<hr/>	<hr/>
Total	\$111,122.31	\$82,669.40
Nontaxable income and additional deduc- tion:		
(c) Net capital gains.....	29,815.84	
	<hr/>	<hr/>
Net income adjusted (before community property division)	\$ 81,306.47	\$82,669.40
Your community share of net income ad- justed	\$ 40,653.24	\$41,334.70

EXPLANATION OF ADJUSTMENTS

(a) Total gain from sale of properties, reported as capital gain, in the amount of \$50,894.64 is taxable in full as business income.

(b) The short-term capital loss of \$576.11 claimed from the sale or exchange of 260 shares of Roland Apartment Corporation stock is disallowed for lack of substantiation.

(c) The net capital gain reported in the amount of \$29,239.73 has been increased by the short-term capital loss disallowed in item (b) above, and the corrected amount of \$29,815.84 is eliminated from income as capital gain and included as business income under item (a) above, for the reason previously explained.

COMPUTATION OF INCOME AND VICTORY TAX CURRENT TAX PAYMENT ACT OF 1943

Taxable Year Ended December 31, 1943

Income tax net income adjusted.....		\$40,653.24
Less: Personal exemption	\$ 250.00	
Credit for dependents.....	700.00	950.00
		<hr/>
Surtax net income.....		\$39,703.24
Less: Earned income credit.....	\$ 1,400.00	
		<hr/>
Income subject to normal tax.....		\$38,303.24
Normal tax at 6 per cent on \$38,303.24....	\$ 2,298.18	
Surtax on \$39,703.24....	16,838.98	
		<hr/>
Total income tax.....		\$19,137.17
Net income tax.....		\$19,137.17
Victory tax net income adjusted.....	\$41,334.70	
Less: Specific exemption.....	624.00	
		<hr/>
Income subject to victory tax.....	\$40,710.70	
Victory tax before credit (5% of \$40,710.70)	\$ 2,035.54	
Less: Victory tax credit (44%) limited to	700.00	
		<hr/>
Net victory tax.....		1,335.54
		<hr/>
1—Net income tax and victory tax.....		\$20,472.71
2—Income tax for 1942.....		\$ 3,221.20
3—Amount of item 1 or 2, whichever is larger.....		\$20,472.71
4—Forgiveness feature:		
(a) Amount of item 1 or 2, which- ever is smaller	\$ 3,221.20	
(b) Amount forgiven ($\frac{3}{4}$ of (a))....	2,415.90	
		<hr/>
(c) Amount unforgiven		805.30
		<hr/>
5—Correct income and victory tax lia- bility (item 3 plus item 4(c)).....		\$21,278.01
6—Income and victory tax liability shown on return account No. NA-776329.....		13,364.36
		<hr/>
7—Deficiency of income and victory tax.....		\$ 7,913.65

[Endorsed] : Filed T. C. U. S. April 29, 1947.

The Tax Court of the United States
Docket No. 13721

EDDY D. FIELD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition filed herein, admits and denies as follows:

First & Second: Admits the allegations contained in paragraphs First and Second of the petition.

Third: Admits that the taxes in controversy are Income and Victory taxes for the taxable year ending December 31, 1943; denies the remainder of the allegations contained in paragraph Third of the petition.

Fourth (a): Denies the allegations contained in subparagraph (a) of paragraph Fourth of the petition.

Fifth (a): Admits that the properties in question were owned by the petitioner and his wife, Helen Field, as community property; denies the remainder of the allegations contained in subparagraph (a) of paragraph Fifth of the petition.

(b) Denies the allegations contained in subparagraph (b) of paragraph Fifth of the petition.

Sixth: Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL,

Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,

Division Counsel.

EARL C. CROUTER,

A. J. HURLEY,

Special Attorneys,

Bureau of Internal Revenue.

[Endorsed]: Filed T.C.U.S. June 3, 1947.

The Tax Court of the United States

Docket No. 13722

HELEN FIELD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice

of deficiency dated February 25, 1947 (LA:IT:90D:LES) and, as a basis of her proceeding, alleges as follows:

First: Petitioner is a resident of Los Angeles, Los Angeles County, California.

Second: The notice of deficiency (copy of which is attached hereto and made a part hereof as Exhibit "A") was mailed to petitioner on or about February 25, 1947.

Third: The taxes in controversy are Income and Victory taxes for the taxable year ending December 31, 1943, in the amount of \$8,083.13.

Fourth: The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner erred in determining that said properties sold by petitioner's husband, Eddy D. Field, in 1942 and 1943 were not capital assets within the meaning of Section 117 (a) (1) of the Internal Revenue Code, and in determining that the gains from the sale or exchange of these properties are fully taxable as business income.

Fifth: The facts upon which petitioner relies, as a basis for this proceeding, are as follows:

(a) Petitioner's husband, Eddy D. Field, has for several years last past been a licensed Real Estate Broker under the laws of the State of California; that his principal income during said years was from commissions realized from the sale of property belonging to others, commissions received for property management and commissions earned in the sale of insurance. The properties in ques-

tion were owned by petitioner and her husband, Eddy D. Field, as community property and the taxable profit upon their sale was reported one-half by petitioner, and one-half by petitioner's husband. The properties in question were purchased by petitioner and her husband as investment properties. They were not properties held primarily for sale to customers in the ordinary course of her husband's trade or business, or properties of a kind excepted from the definition of "Capital Assets" contained in Section 117 (a) (1) of the Internal Revenue Code. They were investment properties held by petitioner's husband, and the profit upon their sale or exchange was properly reported by him as capital gains.

(b) In so far as the Commissioner, in determining petitioner's 1943 tax liability, increased the same by virtue of increasing the tax liability shown due on petitioner's 1942 income tax return, the same is erroneous because a redetermination thereof on said 1942 liability is barred by Section 275 (a) of the Internal Revenue Code.

Wherefore, petitioner prays that this Court may hear and determine:

(a) That the real property sold by petitioner's husband, Eddy D. Field, in the years of 1942 and 1943 were Capital Assets and subject to tax as such.

(b) That the statute of limitations has barred

respondent's right to increase the tax liability as shown by her return filed for the year 1942.

/s/ HELEN FIELD,

Petitioner.

/s/ GEORGE BOUCHARD,

Counsel for Petitioner.

State of California,

County of Los Angeles—ss.

Helen Field, being first duly sworn, on oath says:

That she is the petitioner herein; that she has read the foregoing Petition and is familiar with the statements contained therein and the facts stated therein are true, except as to those facts stated on information and belief, and those facts she believes to be true.

/s/ HELEN FIELD.

Subscribed and sworn to before me this 25th day of April, 1947.

[Seal] /s/ MARY E. McKNIGHT,

Notary Public in and for Said
County and State.

My Commission Expires 8/5/48.

EXHIBIT "A"

Treasury Department
Internal Revenue Service
417 South Hill Street,
Los Angeles 13, California

Office of Internal Revenue Agent in Charge
Los Angeles Division
LA:IT:90D:LES

Feb. 25, 1947.

Mrs. Helen Field
940 South La Brea Avenue
Los Angeles 35, California

Dear Mrs. Field:

You are advised that the determination of your income and victory tax liability for the taxable year ended December 31, 1943, discloses a deficiency of \$8,083.13, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday or Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge,

Los Angeles, California, for the attention of LA:
Conf.

The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,

Commissioner.

By /s/ GEORGE D. MARTIN,

Internal Revenue Agent in
Charge.

Enclosures:

Statement

Form of waiver

LA:IT:90D:LES

Mrs. Helen Field

940 South LaBrea Avenue

Los Angeles 35, California

Tax Liability for the Taxable Year
Ended December 31, 1943

Income and victory tax

Deficiency

\$8,083.13

In making this determination of your income and victory tax liability careful consideration has been

given to the report of examination dated January 27, 1947.

The properties sold in 1942 and 1943 from which you reported net capital gains in the amounts of \$3,607.19 and \$29,239.73 respectively, are not capital assets within the meaning of section 117(a)(1) of the Internal Revenue Code, and the gains from the sale or exchange of the properties reported in 1942 and 1943 are fully taxable as business income. The net capital gains reported have been adjusted to reflect their proper status as business income.

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1942

Net income as disclosed by return (before community property division of income).....		\$22,930.88
Unallowable deductions and additional income:		
(a) Rent	\$ 30.00	
(b) Income from business.....	5,804.18	
(c) Auto expense	295.70	
(d) Travel and entertainment expense	13.14	6,143.02
Total		29,073.90
Nontaxable income and additional deductions:		
(e) Net gain from sale or exchange of capital assets	\$ 3,607.19	
(f) Gardening supplies .....	.40	3,607.59
Net income adjusted (before community property division)		\$25,466.31
Your share community (1/2 of \$25,466.31).....		\$12,733.15

EXPLANATION OF ADJUSTMENTS

(a) You deducted as a charge to outside rental commissions, the amount of \$30.00, which is disallowed due to lack of substantiation.

(b) The amount of gain from the sale of property, \$5,804.18, is taxable in full as business income, as previously explained.

(c) and (d) Auto expense, (\$295.70), and travel and entertainment expense, (\$13.14); deducted in excess of the amounts shown by your books of account and not substantiated are disallowed.

(e) The net capital gain reported in the amount of \$3,607.19 is eliminated, as such, from income and included as business income under item (b) above.

(f) Gardening supplies as shown by your books of account amounted to \$7.83, whereas you claimed as a deduction on your return \$7.43. The difference of .40 cents is allowed as a deduction.

COMPUTATION OF TAX

Taxable Year Ended December 31, 1942

Net income adjusted.....	\$12,733.15
Less: Personal exemption	950.00
Balance (surtax net income).....	\$11,783.15
Less: Earned income credit (10% of \$12,733.15).....	1,273.31
Net income subject to normal tax.....	\$10,509.84
Normal tax at 6% on \$10,509.84.....	\$ 630.59
Surtax on \$11,783.16.....	2,590.61
Total normal tax and surtax.....	\$ 3,221.20
Total income tax.....	\$ 3,221.20
Correct income tax liability.....	\$ 3,221.20

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1943

	Income Tax Net Income	Victory Tax Net Income
Net income as disclosed by return (before community property division of income)	\$ 59,651.56	\$31,774.76
Unallowable deductions and additional income:		
(a) Income from business.....	50,894.64	50,894.46
(b) Short-term capital loss.....	576.11	
Total	\$111,122.31	\$82,669.40
Nontaxable income and additional deductions:		
(c) Net capital gains.....	29,815.84	
Net income adjusted (before community property division)	\$ 81,306.47	\$82,669.40
Your community share of net income adjusted	\$ 40,653.23	\$41,334.70

EXPLANATION OF ADJUSTMENTS

(a) Total gain from sale of properties, reported as capital gain, in the amount of \$50,894.64 is taxable in full as business income.

(b) The short-term capital loss of \$576.11 claimed from the sale or exchange of 260 shares of Roland Apartment Corporation stock is disallowed for lack of substantiation.

(c) The net capital gain reported in the amount of \$29,239.73 has been increased by the short-term capital loss disallowed in item (b) above, and the corrected amount of \$29,815.84 is eliminated from income as capital gain and included as business income under item (a) above, for the reason previously explained.

COMPUTATION OF INCOME AND VICTORY TAX—
CURRENT TAX PAYMENT ACT OF 1943

Taxable Year Ended December 31, 1943

Income tax net income adjusted.....	\$40,653.23
Less: Personal exemption.....	950.00
Surtax net income.....	\$39,703.23
Less: Earned income credit.....	1,400.00
Income subject to normal tax.....	\$38,303.23
Normal tax at 6 per cent on \$38,303.23....	\$ 2,298.19
Surtax on \$39,703.23....	16,838.98
Total income tax.....	\$19,137.17
Net income tax.....	\$19,137.17
Victory tax net income adjusted.....	\$41,334.70
Less: Specific exemption	624.00
Income subject to victory tax.....	\$40,710.70
Victory tax before credit (5% of \$40,710.70)	\$ 2,035.54
Less: Victory tax credit (40%) limited to	500.00
Net victory tax.....	\$ 1,535.54
1—Net income tax and victory tax.....	\$20,672.71
2—Income tax for 1942.....	\$ 3,221.20
3—Amount of item 1 or 2, whichever is larger.....	\$20,672.71
4—Forgiveness feature:	
(a) Amount of item 1 or 2, whichever is smaller.....	\$ 3,221.20
(b) Amount forgiven (¾ of (a))....	2,415.90
(c) Amount unforgiven	805.30

5—Correct income and victory tax liability (item 3 plus item 4(c)).....	\$21,478.01
6—Income and victory tax liability shown on return account No. NA-776328.....	13,394.88
7—Deficiency of income and victory tax.....	\$ 8,083.13
[Endorsed] : Filed T. C. U. S. April 29, 1947.	

The Tax Court of the United States
Docket No. 13722

HELEN FIELD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition filed herein, admits and denies as follows:

First & Second: Admits the allegations contained in paragraphs First and Second of the petition.

Third: Admits that the taxes in controversy are Income and Victory taxes for the taxable year ending December 31, 1943; denies the remainder of the allegations contained in paragraph Third of the petition.

Fourth (a): Denies the allegations contained in subparagraph (a) of paragraph Fourth of the petition.

Fifth (a): Admits that the properties in question were owned by the petitioner and her husband,

Eddy D. Field, as community property; denies the remainder of the allegations contained in subparagraph (a) of paragraph Fifth of the petition.

(b) Denies the allegations contained in subparagraph (b) of paragraph Fifth of the petition.

Sixth: Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL—ECC,
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

EARL C. CROUTER,
A. J. HURLEY,
Special Attorneys,
Bureau of Internal Revenue.

[Endorsed]: Filed T.C.U.S. June 3, 1947.
The Tax Court of the United States

Docket Nos. 13721, 13722

EDDY D. FIELD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

HELEN FIELD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petitioners, husband and wife, in the taxable years 1942 and 1943 realized income from the sale of various parcels of real estate owned by them as community property. During these same years they also derived community income from a real estate and insurance brokerage business conducted by the husband and from the rental of other property. Held, that the real properties sold by petitioners in the taxable years were not capital assets within the meaning of section 117(a)(1) of the Internal Revenue Code, and that the profit derived constituted ordinary income and not capital gain.

GEORGE BOUCHARD, ESQ.,

For the petitioners.

A. J. BURLEY, ESQ.,

For the respondent.

MEMORANDUM FINDINGS OF FACT
AND OPINION

These proceedings, consolidated for trial and decision, involve the following deficiencies in income and victory taxes for the calendar year 1943:

	Docket No.	Amount
Eddy D. Field.....	13721	\$7,913.65
Helen Field	13722	8,083.13

In each case the petitioner's tax liability for the taxable year 1942 is involved by reason of the forgiveness features of the Current Tax Payment Act of 1943.

The sole issue herein is whether income derived by petitioners in 1942 and 1943 from the sale of certain real properties constitutes ordinary income or was taxable as capital gain under the provisions of section 117(a)(1) of the Internal Revenue Code.

Petitioners appear to have abandoned the question raised with respect to whether the Commissioner is barred under section 275(a) from redetermining petitioners' income tax liability for 1942 in connection with computing their tax liability for 1943 under the provisions of the Current Tax Payment Act of 1943. In any event, it is clear that such a contention cannot be maintained. Lawrence W. Carpenter, 10 T.C. 64, Fred B. Snite, 10 T.C. 523.

FINDINGS OF FACT

The petitioners Eddy D. Field and Helen Field are husband and wife, residing at Los Angeles, California. For each of the taxable years involved they filed separate individual income tax returns with the collector of internal revenue for the sixth district of California. The tax liability of Helen Field is involved herein as the real property in question was held by her and her husband as community property under California law.

Eddy D. Field obtained a real estate brokerage license in 1927 and since that time has been engaged in business as a real estate and insurance broker in

Los Angeles, California. During the taxable year 1943, he maintained three offices in that city and employed a number of real estate salesmen. His organization between January 1, 1942, and December 31, 1943, handled the sale of over 300 properties for which he received total commissions of \$52,-039.07 in 1942 and \$72,177.83 in 1943.

In 1934, Eddy D. and Helen Field organized a corporation known as Oxford Associates, paying in the amount of \$2,000, and taking in exchange therefor all of the stock which they thereafter held equally. This corporation was organized to take title to various pieces of real estate which petitioners might acquire from time to time.

Between 1934 and 1941, Oxford Associates acquired various real estate properties in Los Angeles. Some of these properties it sold during this period but most were held as income producing units.

On December 31, 1941, Oxford Associates was dissolved and the following 19 properties were distributed to Eddy D. and Helen Field as its sole stockholders:

2646 Vineyard—Baker Apartments (45 units);
300 S. Clark—1639 Gower (parking lot);
341 N. Croft—Lot 8, Block 39, Tract 9300;
1144 Hi-Point—Lot 22, Block 20, Tract 6450;
338 N. LaBrea—Lot 144, Tract 5070;
1248 S. LaJolla—Lot 145, Tract 5070;
1108 S. Longwood—Lot 146, Tract 5070;
1315 S. Roxbury (or Rockdale)—Lot 147, Tract 5070;

2646 Van Ness—Lot No. 1, Block 5, Tract 7803;
6016 Whitworth—

Of these properties, 11 were improved income producing properties and 8 were unimproved lots. Of the 11 improved properties acquired as a result of the liquidation, petitioners sold the following described parcels in the year 1942:

	Date Acquired	Date Sold	Sale Price	Cost Price
1108 S. Longwood.....	1/1/42	3/ 4/42	\$ 9,650	\$ 8,304.68
1315 S. Roxbury.....	1/1/42	7/23/42	11,950	9,824.04

On January 26, 1942, Helen Field sold a residence at 1500 South Hauser for \$9,100. She acquired a half interest in the property in 1936 and purchased the remaining one-half interest in 1939. There was realized on the disposition of this property a gain of \$1,697.96.

The property at 1315 South Roxbury was a four-unit apartment acquired by Oxford Associates in 1938. It was sold in 1942 and the proceeds were used to apply on the purchase price of an eight-unit apartment at 6282 Commodore Sloat Drive.

Petitioners reported in their income tax returns for 1943 as long-term capital gain and profit from the sale of the following properties:

	Date* Acquired	Date Sold	Sale Price	Cost Price
1248 S. LaJolla....	1/ 1/42	5/12/43	\$17,109.66	\$13,500.00
2646 Vineyard.....	1/ 1/42	6/16/43	13,250.00	10,500.00
900 Kenmore	12/26/41	6/ 9/43	44,000.00	32,022.91
6282 Commodore Sloat Dr.	8/29/42	6/11/43	23,900.00	19,715.52
341 N. Croft.....	1/ 1/42	6/ 5/43	9,524.37	7,026.93
1144 S. Hi-Point..	1/ 1/42	9/16/43	7,499.96	5,500.00
2203 Beechwood ..	3/24/43	10/13/43	57,500.00	44,500.00
300 S. Clark.....	1/ 1/42	8/ 5/43	14,000.00	9,520.00

By the end of the calendar year 1943, petitioners had sold all but four of the income producing properties and the eight unimproved lots received on the liquidation of Oxford Associates.

From the sale of the first four properties listed above as sold in 1943 and the sale of a 14-unit building on West 17th Street, petitioners realized approximately \$44,000, which sum they used in the purchase of a 5-story 75-unit apartment house at 1830 North Cherokee. The Cherokee property was purchased in July, 1943, for \$176,000 and required a down-payment of \$35,000 and an additional \$1,500 for taxes and escrow expenses. This apartment building is still owned by the petitioners. Petitioners received monthly rentals of approximately \$1,900 from the five properties sold to finance the Cherokee purchase, whereas the monthly rental income of the Cherokee apartments is in excess of \$4,600.

The property at 341 North Croft was sold on June 5, 1943, and the proceeds used to purchase a 12-unit apartment at 6439 South Orange which petitioners in turn sold on July 8, 1943. A house at 1144 South Hi-Point and a 10-unit apartment at 2203 Beechwood were sold by petitioners and the proceeds used to buy an interest in a 6-story apartment house at 801 South Gramercy. A 4-unit apartment at 300 South Clark was sold and the money

*The properties which are shown as being acquired by petitioners on January 1, 1942, are the properties petitioners received from Oxford Associates on liquidation on that date. These properties were all acquired by the corporation between 1943 and 1941.

obtained was used to purchase two double bungalows on a corner lot which cost \$8,000 and produced substantially the same income.

In addition to the properties acquired from Oxford, petitioners reported as short-term capital gain the profits from the sale of other real estate during the calendar year 1943 as follows:

Address	Date Acquired	Date Sold	Sale Price	Cost Price
626 W. 17th St.....	6/23/43	6/23/43	\$17,500.00	\$12,750.00
6439 S. Orange....	6/ 1/43	7/ 8/43	27,300.00	24,825.51
424 Kings Rd.....	2/24/43	3/24/43	6,450.00	6,006.00
526 Harper	1/ 9/43	2/26/43	5,900.00	5,049.53
849 S. Holt.....	6/ 6/43	7/ 6/43	7,000.00	6,357.51
1208 Pointview	2/20/43	3/23/43	6,900.00	6,751.96
2031 Manning	10/ 1/43	11/ 1/43	5,600.00	4,533.10

The net rental income derived by petitioners during the calendar years 1942 and 1943 from rental property was \$11,287.58 and \$16,958.08, respectively.

The real properties sold by petitioners during the taxable years 1942 and 1943 were properties held primarily for sale to customers in the ordinary course of their trade or business of buying and selling real estate for profit.

The deficiency notice in each case reads as follows:

The properties sold in 1942 and 1943 from which you reported net capital gains in the amounts of \$3,607.19 and \$29,239.73 respectively, are not capital assets within the meaning of section 117(a)(1) of the Internal Revenue Code, and the gains from the sale or exchange of the properties reported in 1942 and 1943 are fully taxable as business income. The net capital gains reported have been adjusted to reflect their proper status as business income.

OPINION

Arundell, Judge: Specifically, the question herein is whether the properties sold by petitioners in 1942 and 1943 were capital assets within the meaning of section 117(a)(1) of the Internal Revenue Code* or were "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

During the taxable years involved, Eddy D. Field was engaged in business as a real estate and insurance broker. Apart from this business he was also engaged in holding and renting various properties, chiefly apartments, all of which were owned by him and his wife as community property. Respondent's contention is that the transactions involving the purchase and sale of various properties during 1942 and 1943 were of sufficient frequency and continuity to establish the petitioner in a third trade or business, that of selling real estate on his own account.

Numerous tests have been applied by the courts in determining whether the conduct of a taxpayer in acquiring and selling real estate constitutes the carrying on of a trade or business. See *Boomhower v. United States*, 74 F. Supp. 997. The courts have

*Sec. 117. Capital Gains and Losses.

(a) Definitions.—As used in this chapter—

(1) Capital Assets.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be in-

considered the frequency and continuity of the sales or sales related activity over a period of time, *Miller v. Commissioner*, 102 Fed.(2d) 476; the activity of the seller and those acting under his instructions or in his behalf, or the time and labor given to effect the transactions such as by improvements or advertisement to attract purchasers, *Oliver v. Commissioner*, 138 Fed. (2d) 910; the extent or substantiality of the transactions, *Miller v. Commissioner*, *supra*; and to some extent the reasons for, purpose or nature of the acquisition of the property, *Harriss v. Commissioner*, 143 Fed. (2d) 279; *Kanawha Valley Bank*, 4 T.C. 252.

To ascertain whether petitioners were engaged during the taxable years in the business of selling real estate on their own account, we must examine all of the transactions during those years and not only those from which the petitioners reported the profit as long-term capital gain. We also may look to the sales made by petitioners in other years insofar as they relate to the frequency and continuity of such transactions. *Phipps v. Commissioner*, 54 Fed. (2d) 469.

The record discloses that petitioners in 1943 handled no less than 25 separate transactions involving 10 purchases and 15 sales of rental properties. It is significant that 7 of the 10 properties purchased in 1943 were resold within two months

cluded in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, * * *.

after the date of purchase. Although petitioners offer various reasons to account for the sale of these properties, we regard such a rapid turnover of properties, all at a profit, as inconsistent with the concept of investing in real property for the purpose of securing rental income.

In the calendar years 1942, 1943, and 1944 petitioners sold a total of 27 different real properties, all at a profit. Three properties were sold in 1942 for \$30,700, from which net gains of \$5,169.24 were realized. In 1943, they sold 15 parcels for \$263,433.99, from which they derived net gains of \$50,894.64. In contrast, petitioners reported net rental income of \$11,287.58 and \$16,958.08 for 1942 and 1943, respectively. In 1944 nine properties were sold.

These facts demonstrate that the transactions were of sufficient frequency, continuity and substantiality to constitute the carrying on of a business.

Petitioners explain that these properties were purchased and held by them for investment with the idea of later selling them to acquire larger properties which they regarded as better investments. Petitioners' reasons for purchasing the various properties in question are of little significance if the sales were so extensive as to establish them in the business of selling real estate on their own account. *Ehrman v. Commissioner*, 120 Fed. (2d) 607; *Richards v. Commissioner*, 81 Fed. (2d) 369.

Moreover, in view of the number of properties handled by the petitioners, this explanation actually

indicates that they were in the business of buying and selling realty for a profit and using those profits to increase their investments in other rental property. We would not think it important that they chose to retain such rental units as the 45-unit Baker and 75-unit Cherokee Apartments. How a taxpayer may invest his profits would seem to have little bearing on the question of whether or not he is engaged in a trade or business.

The property at 1500 South Hauser which contained four rental units was acquired by Helen Field in 1936 and sold by her in 1942. The profit realized on this transaction appears to have been treated as community property and the petitioners reported one-half thereof on their separate Federal income tax returns. It is suggested that this transaction was not handled along with the other purchases and sales and that clearly the profit should be treated as a long-term capital gain. In the absence of more detailed evidence and in view of the casual treatment accorded this transaction on brief, we are disposed to treat the profit from this sale in the same manner as the gain from the other properties sold by the petitioners during the taxable years.

On all of the facts of record, we are of the opinion that the properties sold by petitioners during 1942 and 1943 were held by the taxpayers primarily for sale to customers in the ordinary course of their trade or business and that the gain realized from the sale of these properties is properly taxable as business income and not as capital gain under the

provisions of section 117(a)(1) of the Internal Revenue Code.

Entered Feb. 23, 1949.

Decision will be entered under Rule 50.

The Tax Court of the United States
Washington

Docket No. 13721

EDDY D. FIELD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the Memorandum Findings of Fact and Opinion of the Court entered February 23, 1949, the respondent herein, on April 5, 1949, filed a recomputation for entry of decision. Hearing was had thereon on May 4, 1949, at which time the recomputation filed by the respondent was not contested by the petitioner. Wherefore, it is

Ordered and Decided: That there is a deficiency in income and victory tax for the calendar year 1943, in the amount of \$7,913.65.

Entered May 4, 1949.

/s/ C. R. ARUNDELL,
Judge.

The Tax Court of the United States
Washington

Docket No. 13722

HELEN FIELD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the Memorandum Findings of Fact and Opinion of the Court entered February 23, 1949, the respondent herein, on April 5, 1949, filed a recomputation for entry of decision. Hearing was had thereon on May 4, 1949, at which time the recomputation filed by the respondent was not contested by the petitioner. Wherefore, it is

Ordered and Decided: That there is a deficiency in income and victory tax for the calendar year 1943, in the amount of \$8,083.13.

Entered May 4, 1949.

/s/ C. R. ARUNDELL,
Judge.

The Tax Court of the United States
Docket No. 13721

EDDY D. FIELD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 13722

HELEN FIELD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

(Met pursuant to notice.)

Before: Honorable C. R. Arundell, Judge.

Appearances: George Bouchard, for the Petitioners.

A. J. Hurley, for the Respondent. [1*]

PROCEEDINGS

The Clerk: Docket No. 13721, Eddy D. Field,
and 13722, Helen Field.

Mr. Bouchard: The Petitioner is ready.

The Clerk: Please state your appearances.

Mr. Bouchard: George Bouchard for the Petitioner.

* Page numbering appearing at top of page of original Reporter's Transcript.

Mr. Hurley: A. J. Hurley for the Respondents.

The Court: Have these cases been consolidated for trial?

Mr. Bouchard: I didn't fill out a formal motion, but I would now like to move that they be consolidated.

Mr. Hurley: No objection.

The Court: They will be consolidated for hearing and disposition. Will you let me have an opening statement, Mr. Bouchard.

Opening Statement on Behalf of Petitioners

By Mr. Bouchard:

Mr. Bouchard: May it please the Court, this is a petition to review a determination made by the Commissioner for the years 1942 and 1943, and the sole issue in the case is whether or not these petitioners are entitled to report the profit on the sales of certain pieces of property at capital gain rates, or whether they are subject to the tax as ordinary income, which is the Commissioner's position. That is the sole issue in the case. [3]

The Petitioner's evidence is going to show, your Honor, that Petitioner Eddy D. Field became a real estate salesman back in 1926. He had no money. In 1927 he secured a broker's license from the State of California, which is one of the early ones, and he still has it, and he has been engaged since 1927 in that business of a real estate and insurance broker. The tax returns will be offered in evidence. From them your Honor will notice that his income during the years in question from the real estate

brokerage and insurance business has been very substantial.

In 1934 the Petitioner and his wife organized a corporation to take title to the properties which they purchased from time to time for investment and rental income purposes. During the time of that corporation's existence, from about 1934 to 1940, the company acquired some nineteen different pieces of property. The Petitioner had started in a very small way, and most all of the properties that he purchased were rental properties, but he was able to buy them at very small down payments and the balances secured by mortgages or trust deeds, and as he went along he intended and hoped eventually to acquire large units. By that I mean forty, fifty, sixty or seventy-five unit apartment houses. That was his goal and his aim, but he had to start out in a small way with such properties as he could buy. He had to sell some that he already had to raise cash. I think that [4] the evidence will show, your Honor, that of the nineteen pieces of property that this corporation acquired in the six years of its existence, the Petitioner still owns about twelve of them.

The Court: You mean the Petitioner?

Mr. Bouchard: Pardon?

The Court: You say the Petitioner, but you speak of a corporation.

Mr. Bouchard: Well, I thought I had made this clear, your Honor. The Petitioner did in 1934 organize a corporation to take title to those investment properties.

The Court: Yes.

Mr. Bouchard: That corporation was dissolved. He and his wife owned all the stock. That was dissolved in 1941, December of that year, and the properties that are the subject of this litigation were distributed to the Petitioner and his wife.

The point I wanted to emphasize in referring to the corporation is, at the time of its organization it was organized for the sole purpose of buying and holding property for future investment. In the year 1942 the Petitioner sold three properties and in 1943 he sold eight or nine. He sold more than that, but in any event the properties which he sold in that year, which he had held over six months, on them he reported his gain at capital gain rates. The Commissioner [5] has denied him that right and claims that he is a dealer who bought these properties primarily for sale, and accordingly is subject to tax at ordinary rates.

It is our contention that the properties which are the subject of this litigation were not properties held primarily for sale, but were properties that were acquired and held for investment and rental income purposes, and of course, if the evidence sustains that position, I presume that the law is that we are entitled to report our profit as we have done. I think that is sufficient.

Opening Statement on Behalf of Respondent
By Mr. Hurley

Mr. Hurley: If the Court please, the issues in

this case—I should say the simple issue in this case is, as Mr. Bouchard has stated, whether the properties in question were held by the Petitioner for sale to customers in the ordinary course of his trade or business. It is true that the majority, I should say the major part of Petitioner's income was received from real estate broker's commissions. Nevertheless we are convinced that the evidence will show that Petitioner was likewise engaged in the business of selling real estate on his own account. In the taxable year he realized in excess of \$50,000.00 from the sale of such properties. It is not necessary under the law for a respondent to prove or to show that the properties were originally purchased for resale to [6] customers. It is sufficient, as I understand the law, that the Respondent show that the properties were held for sale in the ordinary course of the Petitioner's business. The Respondent does not contend that the Petitioner, in 1926 or '27, or even when he originally purchased the property—it is not necessary that the Respondent show such properties were purchased originally for this purpose, but the sales in 1942 and 1943, there were fifteen properties in 1943, there were three properties in 1942 and nine properties in 1944, none of which were sold at anything but a profit, and the transactions were of sufficient frequency and continuity that they constitute a trade or business.

The Court: Were there purchases during those years too?

Mr. Hurley: Yes, your Honor, purchases and sales. That concludes the Respondent's opening statement.

The Court: Is Mrs. Field here simply because this is community property?

Mr. Bouchard: That is right, your Honor.

Mr. Hurley: Yes.

Mr. Bouchard: Mr. Field, please. [7]

Whereupon,

EDDY D. FIELD,

called as a witness for 'and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: Please be seated, state 'your name and address.

The Witness: Eddy D. Field, 940 South La Brea Avenue, Los Angeles.

Mr. Bouchard: At the outset, your Honor, Mr. Hurley and I are stipulating—I think it is government counsel's desire to offer in evidence the tax returns for 1942 and '43.

Mr. Hurley: Yes, at the conclusion of the hearing, your Honor, we intend to use them.

Mr. Bouchard: It is stipulated between us that the dates of acquisition of the properties and dates of sale, the costs and the selling prices are as indicated on the return. Is that correct?

Mr. Hurley: That is correct.

Mr. Bouchard: So we have no problem of proving those matters. [8]

(Testimony of Eddy D. Field.)

Direct Examination

By Mr. Bouchard:

Q. Mr. Field, you have given your address, I believe. A. Yes, I did.

The Court: May I ask, is there any dispute as to the amount of the profits?

Mr. Bouchard: None whatever.

The Court: They are correctly stated on the return?

Mr. Bouchard: That is right.

Mr. Hurley: Yes, your Honor.

Q. (By Mr. Bouchard): Mr. Field, is Helen Field your wife? A. She is.

Q. When were you married?

A. September 14, 1929.

Q. What is your business?

A. Real estate and insurance broker.

Q. In the City of Los Angeles?

A. Yes, sir.

Q. Has Mrs. Field ever been connected with your brokerage or insurance business?

A. Never has.

Q. How long have you been a real estate broker in this city? A. Since 1927. [9]

Q. Do you hold a broker's license in the state?

A. I do.

Q. How long have you had that?

A. Since 1927.

Q. When did you start in business as a real estate salesman or otherwise? A. 1926.

(Testimony of Eddy D. Field.)

Q. What were your financial resources at that time? A. I didn't have any.

Q. Is your real estate and brokerage business incorporated? A. Not now, no.

Q. It was? A. It was, yes, sir.

Q. When was it organized?

A. Originally it was organized in 1927.

Q. And it continued how long?

A. Until about 1934, I believe. Originally it was three partners.

Q. Then what happened?

A. Then two of us bought one partner out, and then I eventually in 1934 bought the other partner out.

Q. So you have been engaged in business on your own account since 1934?

A. 1933 or '34, yes, sir. [10]

Q. Now, Mr. Field, as a real estate broker, what are and have been your duties and your function?

A. Well, we listed the property for sale. We naturally have salesmen working in the office. We caravan the property and inspect the property, and if the property is a salable property, we advertise it, put up signs on it, and we try to sell it.

Q. In other words, you represent buyers and sellers of property? A. That is right.

Q. And on what basis?

A. On a commission basis.

Q. Have you ever held yourself out to the public as being engaged in any business other than a real estate and insurance broker?

(Testimony of Eddy D. Field.)

A. No, I have not.

Q. Did you ever hear of a company known as Oxford Associates? A. Yes, I have.

Q. What was that company?

A. That was a holding company that my wife and I formed in, I think it was 1934.

Q. For what purpose did you organize it?

A. We organized it to purchase rental income properties.

Q. And was the title to such properties as you acquired [11] taken in the name of that corporation? A. That is right.

Q. And you and Mrs. Field owned all the stock?

A. That is right.

Q. What type of property did you first start acquiring?

A. Well, we were limited in money, and we bought small properties, duplexes, five hundred or a thousand dollars down, or four units or whatever we could purchase at the time.

Mr. Hurley: May I interrupt at this point, your Honor? I will request counsel to distinguish at this time between the corporation and the Petitioners individually. When you speak of "you" I think in this instance you refer to the corporation, is that correct?

Mr. Bouchard: I guess it is.

Mr. Hurley: I think for purposes of the record we better have a distinction between the individually acquired properties and corporation properties.

(Testimony of Eddy D. Field.)

The Court: You might place at the outset the date of organization of this corporation. What was the date, and whether any property was paid in and what it was and so forth.

Q. (By Mr. Bouchard): Was there any property turned into this corporation by either of you at the time of its organization?

A. I don't recall that, Mr. Bouchard. There may have been. I really don't recall that, but as I understand, if I [12] understand correctly, we started the corporation and then we bought the capital stock, I think we issued two thousand dollars. That is what my memory recalls. I am not sure.

Q. You paid in \$2000.00?

A. I believe that was it.

Q. In cash for the stock of the company?

A. That is right.

Q. And then this corporation proceeded to acquire small properties where you could make a small down payment and the balance on a mortgage?

A. That is right.

Q. What type of properties did you acquire?

A. Double bungalows, four flats, anything that we could handle with what limited capital we had at the time that would show a rental income.

Q. And they were all rental income properties that were acquired?

A. Yes, at the time, that is right.

Q. This corporation was dissolved when?

(Testimony of Eddy D. Field.)

A. December 31, 1941.

Q. And do you recall how many pieces of property that corporation had acquired between its organization in 1934 and the date of its dissolution in 1941? A. I believe it was nineteen.

Q. Of those nineteen properties, how many of them do [13] you still own?

A. I think it is twelve.

Q. Now, at the time of the dissolution of the corporation, were those properties appraised?

A. Yes, they were.

Q. And the costs that are shown on your tax returns for these properties are what figure?

A. The figure that the appraiser put on.

Q. The fair market as of the date of dissolution in 1941?

A. That is correct. We had an outstanding appraiser appraise them.

Q. Mr. Field, how many sales of real estate did you and your office handle in 1942 on which you received commissions?

A. One hundred and forty-eight.

Q. And how many different sales of some type did you have in 1943?

A. I think it was one hundred fifty-five or one hundred fifty-eight, one of the two, right in there.

Q. Now, in 1942, Mr. Field, you sold a property at 1500 South Hauser. What kind of a property was that?

A. That is a four flat. My wife sold that. That belonged to her.

(Testimony of Eddy D. Field.)

Q. Do you know when she acquired it? [14]

A. She acquired a half interest some time in 1936 from Mr. and Mrs. Newton, and then she acquired the other half interest in 1939, I believe.

Q. And do you know why she sold that property in 1942?

A. Yes. Her mother and sister were living there at the time, and the doctor wanted to get my mother-in-law out of the location, which was rather low, south of Pico.

Q. Why was that Hauser property acquired?

A. Well, she had a chance to buy this with a small down payment with Mr. and Mrs. Newton on a half interest, and then she bought them out, I think in 1939, I believe, for a small down payment there also.

Q. Was that a rental property?

A. Yes. It was four units.

Q. Now in 1942 you also sold a piece of property at 1515 South Roxbury. What kind of a property was that?

A. That was a four unit.

Q. When did you acquire it?

A. Can I refer to my notes, Mr. Bouchard?

Q. Yes, you may.

A. I think I have it right here. The corporation acquired that in 1938, September. We paid \$1500.00 down.

Q. Why did you buy that property?

A. Small down payment and for the rental income. We had to assume the first and second trust deeds on that property [15] too.

(Testimony of Eddy D. Field.)

Q. Why did you sell that property?

A. We sold that property to buy an eight unit located on Commodore Sloat, 6282 Commodore Sloat.

Q. Why did you buy the property on Commodore Sloat?

A. Because we could handle that with a small down payment, and the rental income, which instead of four units we had eight units coming in.

Q. And you purchased that for its rental income? A. That is right.

Q. And now in May of 1943 you sold a property at 1248 South La Jolla. What kind of property was that?

A. That was a four unit. We bought it in about 1938. We paid a thousand dollars down and assumed the first and second liens, and we sold it in 1943. At the time we bought it it happened to be on a key lot adjoining the back of a business, business fronts backed up with the alley, thinking we would hold it. They built a bowling alley and liquor store there, and that made it very disagreeable for the tenants and we sold that. We also applied that to purchase another piece of property.

Q. Why did you buy that property?

A. A thousand dollars down, small down payment, and for the rental income.

The Court: Which property are you talking about now? [16]

(Testimony of Eddy D. Field.)

Mr. Bouchard: La Jolla, your Honor.

The Witness: La Jolla.

Mr. Hurley: If your Honor please, I think perhaps it would assist the Court to get a recapitulation and summary of the properties involved in the taxable year 1943, and this is taken from the return itself.

Q. (By Mr. Bouchard): Now, Mr. Field, in June of 1943 you sold a property at 2646 Vineyard. What kind of a property was that?

A. That was a six unit that we acquired in 1936, January. We acquired that because of the six rentals and we could get it at \$1500.00 down, rental income, and we sold it to buy a seventy-five unit apartment at 1830 North Cherokee.

Q. What address on Cherokee?

A. 1830 North Cherokee.

Q. That is you say a seventy-five unit apartment?

A. Yes, five stores and a seventy-five unit apartment.

Q. When did you acquire that?

A. July, 1943.

Q. What was its purchase price?

A. \$176,000.00.

Q. What down payment?

A. We paid \$35,000.00 down, and then we paid off about \$1500.00 taxes and escrow expenses, about \$36,500.00 roughly.

Q. Do you still own Cherokee? [17]

(Testimony of Eddy D. Field.)

A. Yes, I do.

Q. The original mortgage on that was how much? A. \$140,000.00.

Q. And has it been reduced?

A. It is down to fifty-two or fifty-three thousand I think.

Q. Have you ever had an opportunity to sell that at a profit?

A. Numerous occasions. I turned down \$450,000.00 for it.

Q. Why didn't you sell it?

A. That is the type of property that my wife and I have been wanting to get ever since we have been married. It is a permanent investment as far as we are concerned, shows a nice rental income.

Q. Now in June of 1943 you sold a property at 900 South Kenmore. What kind of property was that? A. That was a twelve unit.

Q. When did you acquire it?

A. December, 1941.

Q. Why did you buy it?

A. A small down payment and the rental income.

Q. Why did you sell it?

A. To purchase Cherokee.

Q. Now in June of 1943 you also sold a property at 341 [18] North Croft. What kind of a property was that? A. That was a duplex.

Q. When had you acquired it?

A. 1935, I believe.

Q. Why did you buy that property?

(Testimony of Eddy D. Field.)

A. That is right, 1935. It was a duplex. We paid \$500.00 down on it and it had a rental income.

Q. Why did you sell Croft?

A. We sold Croft to buy 6439 Orange, which was a twelve unit building.

Q. Now in June of 1943 you also sold a property at 6282 Commodore Sloat Drive. What kind of a property was that?

A. That is an eight unit.

Q. When had you acquired it?

A. August, 1942.

Q. Why did you buy it?

A. Well, the same reason. It was a small down payment there and the rental income. We were trying to increase our income on those rentals all the time.

Q. Why did you sell the Commodore Sloat property?

A. We bought 1830 North Cherokee.

Q. Now, you have told us of four properties you sold in 1943 for the purpose of purchasing Cherokee. How much money did you realize from the sale of these four pieces of property? [19]

A. I would say approximately thirty-six or thirty-seven thousand, somewhere in that neighborhood.

Q. What was your down payment on Cherokee?

A. Thirty-five thousand was the down payment, plus escrow and title expense, taxes, about thirty-six five or thirty-six six, something like that.

Q. Was there some other piece of property that you sold about that time?

A. Yes, I did.

(Testimony of Eddy D. Field.)

Q. And that you purchased Cherokee?

A. On West Seventeenth Street.

Q. What type of a property was that?

A. That was a three story fourteen unit frame building.

Q. Why had you purchased that?

A. Because we could buy it with \$3200.00 down and the income.

Q. And when did you sell that, do you recall?

A. I sold that in June, if I am not mistaken and——

Q. Of 1943? A. That is right, June, 1943.

Q. From these five properties that you sold in order to purchase Cherokee, how much cash did you realize?

A. Around forty-four to forty-five thousand.

Q. These properties that you sold in order to purchase Cherokee, I understand were rental properties? [20]

A. That is right.

Q. What monthly rent did you derive from these five properties that you sold?

A. On the five, nineteen hundred some odd dollars.

Q. A month? A. A month, yes, sir.

Q. What was the monthly income, rental income that you got from Cherokee?

A. \$4600 and something.

Q. And now, in August of 1943 you sold a property at 300 South Park. What kind of a property was that?

(Testimony of Eddy D. Field.)

A. That was a four unit purchased in 1936.

Q. Why did you buy that?

A. Well, we had a chance to buy two double bungalows, showing——

Q. I didn't ask you why you sold it. I asked you why you bought it.

A. Why we bought it was on account of the rental income. Pardon me. I am sorry.

Q. Now you can tell us, why did you sell it?

A. Well, the rents were frozen on 300 South Park. We had a chance to buy two double bungalows on a corner lot that showed almost the same income, at a price of \$8,000.00.

Q. Now in September, 1943, you sold a property at 1144 South Hi-Point. What kind of property was that? [21]

A. That was a house.

Q. When did you acquire it?

A. Back in 1935 or something like that, 1936—1936, January, 1936.

Q. Why did you buy that property?

A. Well, that house was seven hundred fifty down, that is what we paid down on it, and it was rented for \$60.00 a month, which was good income at that time.

Q. And why did you sell it?

A. It became—for two reasons; it became vacant and there was an O.P.A. on it at the \$60.00 rental, and we used the money to help purchase an interest in a six story apartment at 801 South Gramercy.

Q. In October of 1943 you sold a property at

(Testimony of Eddy D. Field.)

2203 Beachwood. What kind of a property was that?

A. That was a ten unit.

Q. When did you acquire that?

A. March, I think it was, 1943.

Q. Why did you buy that property?

A. The down payment and the rental income.

Q. And when you say the down payment, you mean the down payment was——

A. The down payment required.

Q. Was small?

A. Cash down payment, yes. [22]

Q. Why did you sell the Beachwood property?

A. Well, the same reason we sold Hi-Point was one of the reasons, we purchased an interest in the big apartment at 801 Gramercy. It was our aim to get big apartments we would hold to.

Q. How big an apartment was this 801 South Gramercy?

A. It was six story, I believe.

Q. Mr. Field, did you ever use any of the moneys that you received from any of these sales in your brokerage or insurance business?

A. No, I did not. I took the money from the brokerage business.

Q. What did you do with the moneys that you received from the sales of the properties we have been talking about?

A. One of two things: We tried to invest it in better rental properties or to pay off existing trust deeds that we had on the properties some of which

(Testimony of Eddy D. Field.)

had second trust deeds, and we wanted to increase our equity in them as much as possible.

Q. Mr. Field, did you ever hold these properties about which we have been talking, primarily for sale? A. No, I did not.

Q. How much of your time was devoted to handling your rental properties?

A. Practically nothing. There were other offices that I was managing, plus the main office. At that time I think I [23] had two offices plus the main office.

Q. Did any of your employees in the brokerage office devote any of their time to your real estate management?

A. No, they did not. The bookkeeper, Mr. Bouchard, kept the books.

Q. Mr. Field, do you own a property at 338 North La Brea? A. I do.

Q. What kind of a property is that?

A. That is two stores with six apartments above.

Q. And when was that acquired?

A. 1936, I believe.

Q. Is that a rental property?

A. Yes, it is.

Q. Do you own a property known as the Baker Apartments? A. We do.

Q. What kind of a property is that?

A. That is a four story brick, forty-five units.

Q. When did you acquire that?

A. I believe it was 1938.

(Testimony of Eddy D. Field.)

Q. Have you ever had an opportunity to sell that property?

A. Yes. I have turned down numerous offers. I turned down one for \$135,000.00.

Q. Why didn't you sell it? [24]

A. Well, that is the type of property that we like to keep, Mr. Bouchard, shows a good rental income on the investment and good location.

Mr. Bouchard: Your Honor, excuse me just a minute. That is all, your Honor.

Cross-Examination

By Mr. Hurley:

Q. Mr. Field, I believe you testified that you at present still own twelve of the nineteen properties which were transferred to you on the liquidation of the corporation in 1942, at the end of 1941, is that correct?

A. Well, you have a list there. That is what I at that time—we owned the twelve we are talking about at that time. We owned—I can tell you exactly what they are if you want to get the list of them.

Q. Well, I would like to know whether you now own twelve of the nineteen. Is that correct? Yes or no.

A. Yes, I do. We do.

Q. All right, would you give me a list of the twelve properties?

A. That is what I was going to do for you. The first one would be 330 La Brea, 845 West Olympic,

(Testimony of Eddy D. Field.)

two lots one forty-five and one forty-six of tract 5070. Lot 8——

Q. I can't quite keep up. What was the name of that tract on which you had lots? [25]

A. 5070. Westwood corner of Rochester.

Q. What?

A. Corner of Westwood and Rochester. 6030 Whitworth. 1019 La Brea.

Q. Do you think of any others?

A. I can tell you. You get the list there. I am telling you what I recollect, but it is hard to remember back that far on it.

Q. Perhaps Mr. Bouchard can help you out on that. I am simply interested in having an accurate list of the properties.

Mr. Bouchard: Do you want me to ask him?

Mr. Hurley: Yes.

Mr. Bouchard: Do you now own 1639 Gower?

The Witness: We do.

Mr. Bouchard: Do you know when you got that?

The Witness: That was acquired by the corporation.

Mr. Bouchard: When did the company get it, do you recall?

The Witness: I don't recall. I think it might be 1938 or 1937. I really don't know.

Mr. Hurley: Mr. Bouchard, I am simply interested in learning what twelve properties remain from the nineteen received in liquidation of the

(Testimony of Eddy D. Field.)

corporation and their addresses. It is not important when they were acquired. [26]

Mr. Bouchard: Well, I am giving it to you.

Q. (By Mr. Hurley): Do you recall the question?

A. Gower is one, 1639 North Gower. You can read them off.

Mr. Bouchard: 338 and 40 La Brea?

The Witness: We still have that. By the way, that address has been changed, 330 and 32 is the changed address, as I remember.

Mr. Bouchard: You testified to Whitworth.

The Witness: That is right.

Mr. Bouchard: The Baker Apartments.

Mr. Hurley: Pardon me, Mr. Bouchard. Do you have a list of the properties received on liquidation?

Mr. Bouchard: I think this is it right here.

Mr. Hurley: May I have that list and I can perhaps more easily secure the information.

Q. (By Mr. Hurley): Mr. Field, here is a list of properties. A. Okeh.

Q. Distributed to you on the liquidation of the corporation, as I understand it.

A. That is right.

Q. Now, number one is 300 South Clark. Do you still have that property? [27]

A. I do not.

Q. The next is 331 North Croft. Do you still own that property? A. Yes.

(Testimony of Eddy D. Field.)

Q. The next is a parking lot at 1639 Gower. Do you still own that? A. I do.

Q. The next is 1144 Hi-Point. A. No.

Q. 338 North La Brea? A. Yes.

Q. 1248 South La Jolla? A. No, sir.

Q. 1108 South Longwood? A. No.

Q. 1315 South Rockdale? A. No.

Q. 2646 Van Ness? A. No.

Q. 6016 Whitworth? A. Yes.

Q. Baker Apartments? A. Right.

Q. That is a different address than 6016?

A. Yes, that is 845 West Olympic. [28]

Q. Baker Apartments are 845 West Olympic?

A. That is right. We own those.

Q. Lot 8, Block 39, Tract 9300. Do you still own that? A. Yes, we do.

Q. You own all of these unimproved properties?

A. That is right.

Q. All right. For the record I would like to read the other properties: Lot Number 22, Block 20, Tract 6450. Lot 144, Tract 5070. Lot 145, Tract 5070. Lot 146 and 147, two lots, Tract 5070. Lot Number 1, Block 5, Tract 7803. And those are the properties and all of the properties that you received from liquidation?

A. This one I know. I know this one right here. I am not very familiar with this one right here, I just can't place that one. There is a question on some of them.

Q. As to whether or not you still own them or have sold them, is that right?

(Testimony of Eddy D. Field.)

A. That is correct.

Q. At any rate, the list we have just read is the list of properties that you received from liquidation of the corporation?

A. As far as I know that is right.

Q. Now, of those properties, Mr. Field, you still retain, which are income producing properties?

A. All right. The parking lot is leased. [29]

Q. All right.

A. 330 La Brea, that is two stores and six apartments, that is income property. The Whitworth is eight units. The Baker is forty-three or forty-five units. We still have that.

Q. I see. Now, the remaining lots are non-income producing lots, is that correct?

A. Yes.

Q. You mean there are no improvements on those lots?

A. That is right, right now, and they only produce right now for signs and things like that.

Q. So as far as those nineteen properties distributed to you, you have retained only four income producing properties, is that correct?

That is the total that you gave me.

A. Yes, whatever it is, yes. The Westwood corner here, I might tell you on that one right there that I bought this——

Mr. Bouchard: Speak up, Mr. Field. We don't hear you.

The Witness: Originally the lot in Westwood——

(Testimony of Eddy D. Field.)

I bought this originally to—really for the Auto Club, originally to lease it to them, but it didn't work out. I did have a few dickering with me on the lots, but——

Q. (By Mr. Hurley): When was that?

A. Oh, that was quite a while ago, years ago.

Q. Years ago? A. That is right.

Q. Now, Mr. Field, on direct examination, when counsel went down the list of properties starting with 1248 South La Jolla, the dates of acquisition which you testified to were the dates of acquisition by the corporation, is that correct?

A. That is right, by the corporation. The corporation, in other words, 1935, 1937, 1938, any prior to December 31, 1941 would be the corporation.

Q. And the dates shown on your tax returns, which I have made a schedule of here, namely 1-1-42, that property was acquired on the 1st of January, 1942 from the corporation in the liquidation, is that right? A. That is correct.

Q. Now, Mr. Field, during the period that the Oxford Associates Corporation was in existence, did that corporation sell any properties?

A. During the period, do you mean from the time it was incorporated?

Q. Yes.

A. To the time in 1942, before 1942?

Q. Yes.

A. Yes. As I said before, Mr. Hurley, we would buy a piece of property with a small down payment,

(Testimony of Eddy D. Field.)

from the rental [31] income, we would try to better ourselves at all times, increase our rental income or increase our equities, and we did, I don't know how many, I wouldn't have any idea.

Q. Well, they were not infrequent, were they?

A. Well, I couldn't answer that. I wouldn't know about how often—you mean how many pieces were bought?

Q. Yes.

A. Whether it is five or six or seven, that is what you want to know?

Q. Yes. Or ten.

A. I don't think it would be, it might be ten. I don't know. It might not. I don't know.

Q. It could easily be ten pieces of property that were sold by the corporation?

A. No, I don't think so. It might be. I wouldn't know. I can't answer that question, Mr. Hurley.

Q. You recall the property at North Swall Drive acquired by the corporation in 1936?

A. I believe that is a four unit, isn't it? I am not sure. I think it is a four unit. I am not sure.

Q. I mean, do you recall that the property was sold by the corporation.

A. Well, I don't know. What is the address on Swall?

Q. 138 North Swall.

A. Is that the corner of Beverly Boulevard?

Q. You don't recall that was bought in 1936 and sold by the corporation in 1937?

(Testimony of Eddy D. Field.)

A. It might be, I wouldn't say.

Q. You don't have any independent recollection on that?

A. No. I didn't know you wanted to ask that question or I could have looked it up very easily. I believe it is a four unit on the corner of Beverly Boulevard, if I am not mistaken, and Swall.

Q. But in any event the corporation did not own it after 1936, did it?

A. If the corporation sold it in 1936 as you say, they wouldn't own it, would they?

Q. I am not stating that they did. I am inquiring as to whether the corporation did.

A. I can not—back in 1936 I wouldn't know, unless I looked on the books, Mr. Hurley. That would be impossible.

Q. Mr. Field, do you know what your gain in dollars, without any distinction as to short term and long term capital gain, was in the taxable year 1943 on the sale of properties for your own account, that is properties purchased for you and sold by you?

A. Well, I believe your income tax statement would show it, wouldn't it, Mr. Hurley?

Mr. Hurley: For the convenience of the Court, I would like to introduce in evidence as Respondent's Exhibits [33] A and B schedules showing the gain on sales of property by the Petitioner in the taxable year 1943. I will give counsel an opportunity to check these schedules with the returns.

(Testimony of Eddy D. Field.)

Mr. Bouchard: I take it you have copies that out of the returns?

Mr. Hurley: Yes, Mr. Bouchard, I have, and in the event there should be any great variance, the returns are in evidence and would be the primary evidence on the question.

The Clerk: Exhibits A and B.

The Court: They will be received.

(The documents above referred to were received in evidence and marked Respondent's Exhibits A and B.)

(Testimony of Eddy D. Field.)

EXHIBIT A

Properties Sold in Year 1943

Address	Short Term		Sale Price	Cost Price	Sell. Exp. Add'l Costs	Gain
	Date Acquired	Date Sold				
626 West 17th Street.....	6/23/43	6/23/43	17,500.00	12,750.00	957.03	3,792.97
6439 South Orange.....	6/ 1/43	7/ 8/43	27,300.00	24,825.51	155.00	2,319.49
424 Kings Road.....	2/24/43	3/24/43	6,450.00	6,006.00	22.65	421.35
526 Harper	1/ 9/43	2/26/43	5,900.00	5,049.53	52.50	797.97
849 South Holt	6/ 6/43	7/ 6/43	7,000.00	6,357.51	56.87	585.62
1208 Pointview	2/20/43	3/23/43	6,900.00	6,751.96	101.30	46.74
2031 Manning	10/ 1/43	11/ 1/43	5,600.00	4,533.10	294.00	772.90

(Testimony of Eddy D. Field.)

EXHIBIT B

Properties Sold in Year 1943

Address	Long Term					Gain
	Date Acquired	Date Sold	Sale Price	Cost Price	Sell. Exp. Add'l Costs	
1248 South La Jolla.....	1/ 1/42	5/12/43	17,109.66	13,500.00	409.66	3,670.00
2646 Vineyard	1/ 1/42	6/16/43	13,250.00	10,500.00	113.45	3,061.55
900 Kenmore	12/26/41	6/ 9/43	44,000.00	32,022.91	1,712.65	11,109.04
341 So. Croft	1/ 1/42	6/ 5/43	9,524.37	7,026.93	70.70	2,689.24
1144 So. Hipoint.....	1/ 1/42	9/16/43	7,499.96	5,500.00	293.75	1,906.21
2203 Beechwood	3/24/43	10/13/43	57,500.00	44,500.00	773.56	12,226.44
300 So. Clark	1/ 1/42	8/ 5/43	14,000.00	9,520.00	89.40	4,690.60
6282 Commodore Sloat Dr.....	8/29/42	6/11/43	23,900.00	19,715.52	1,565.02	2,804.52

(Testimony of Eddy D. Field.)

Q. (By Mr. Hurley): Mr. Field, I ask you, in the year 1943 you sold a property on 626 West Seventeenth Street, is that correct?

A. That is right.

Q. When was that property acquired? Do you have your notes there?

A. Just a minute. I will refer to my notes here. June 23, 1943.

Q. It was acquired on June 23, and sold on June 23, is that correct?

A. It was acquired and went to escrow on May 11, 1943. That is when we went to escrow, May 11. The close of the escrow was June 23. That was one of the properties that we [34] had to sell in the Commodore, 1839 North Cherokee, that is the Commodore property.

Q. The tax return shows that the property was acquired on June 23, 1943.

A. That is when we acquired it. We went to escrow May 11.

Q. The property at 6439 South Bennett, was that property sold in 1943? A. Yes, it was.

Q. On what date was that property acquired?

A. Acquired that on May 22. That is the date it was filed.

Q. When was it sold? A. July 6, 1943.

Q. And the property at 424 Kings Road, when was that property acquired?

A. That was acquired on September 24—pardon me, February 24, 1943.

(Testimony of Eddy D. Field.)

Q. 1943? A. That is right.

Q. When was it sold? A. March 24, 1943.

Q. I didn't quite understand you.

A. March 24, 1943.

Q. The property at 526 Harper, when did you acquire [35] that property?

A. We opened the escrow January 9 and we acquired it on February 25, 1943.

Q. And it was sold on February 26, 1943, is that correct?

A. Yes. I have it here February 25. I don't know.

Q. When was it acquired?

A. We went to escrow on January 9 and we acquired it February 25.

Q. When was it sold?

A. Is that right now, Mr. Bouchard?

Q. The same day?

A. No, it was not sold the same day. We opened the escrow here on January 9, 1943.

Q. What date was the property sold?

A. February 25, 1943.

Q. It was sold on February 25, 1943?

A. Yes. Now, then, I will explain that to you. We went to escrow January 9. In the meantime we had a chance to purchase a four story building at 739 South Normandie, and we had to have some money, so we turned around and sold this particular property.

Q. And how about the property at 849 South Holt, when was that acquired?

(Testimony of Eddy D. Field.)

A. We bought that or acquired it I think June 6, 1943, [36] I believe.

Q. On June 6th? A. I think it was.

Q. When was it sold? A. July 6th.

Q. 1943?

A. Yes. That was bought, my mother-in-law and my sister, we bought that property for her. After the purchase and while in escrow she had a stroke and couldn't move into the house, was never in that house.

Q. How about the property at 2012 Point View. When was that acquired?

A. February 20, 1943.

Q. When was it sold?

A. March 15, 1943 we sold that to purchase Beachwood.

Q. The property at 2031 Manning, when was that purchased? A. October 1, 1943.

Q. When was it sold?

A. November 9, 1943.

Q. Now, Mr. Field, you likewise sold properties in 1944 which were acquired by you in 1943 and prior dates, is that correct?

Mr. Bouchard: That is objected to as incompetent, irrelevant and immaterial, what he did at any time after [37] December 31, 1943.

The Court: Overruled.

Q. (By Mr. Hurley): Do you have your notes on your 1944 transactions? A. I do not.

Q. Mr. Field, I have what purports to be your

(Testimony of Eddy D. Field.)

individual 1944 income tax return. Is that your signature? A. Yes, sir.

Q. Do you recognize the return?

A. That is my signature on it. I imagine it is mine.

Q. I direct your attention to Schedule D on that return, in which you list the sales of property.

A. Yes.

Q. Made in that year? A. Yes.

Q. Now, according to that schedule you sold a property at 744 North Ogden on the date indicated, 11-26-43, and the date sold was January 22, 1944, is that correct?

A. That is it. That must be correct, yes, sir.

Mr. Hurley: If your Honor please, if I can introduce the return it would expedite the trial. If Mr. Bouchard has no objection. I would like to introduce the return which the witness has testified that the schedule which is attached to the return is the correct account of the transactions made in the year 1944. [38]

Mr. Bouchard: Of course, I think your Honor has overruled me on my objection.

The Court: I think you may make a general inquiry into the conduct of his business both before and after the date, but I don't know that we should have testimony on the detail of transactions.

Mr. Hurley: Yes, your Honor. I am simply trying to show——

The Court: You are just trying to show that he is in business as a trader both before and after

(Testimony of Eddy D. Field.)

the tax date, but I don't think you should have the details about it.

Mr. Hurley: No, I only intended, your Honor, to show enough of the transactions in 1944 on properties acquired in 1943, and almost contemporaneously with the sales, so as to show that there was a continuous business of buying and selling properties, and not simply a liquidation of properties acquired years and years ago for other purposes, and I would propose therefore to show it in the examination simply by asking Mr. Field whether or not he has sold nine properties in 1944.

The Witness: That is right.

Q. (By Mr. Hurley): Are those all improved income producing properties, Mr. Field?

A. Yes, they are. [39]

Q. They are? A. They are, yes, sir.

Mr. Hurley: I would also like to have in evidence, your Honor, the fact that the amount of those sales aggregated \$33,163.24. Would you stipulate to that figure, Mr. Bouchard?

Mr. Bouchard: That is 1944?

Mr. Hurley: That is for 1944.

Mr. Bouchard: I assume that is correct.

Q. (By Mr. Hurley): I further ask you, Mr. Field, whether all these properties were sold at a gain and none of the properties sold at a loss. Is that correct?

A. That is right. I can tell you why they were sold if you want to know.

(Testimony of Eddy D. Field.)

Q. Well, I don't think that would be necessary at this time. I would further like to ask you whether or not the properties sold in 1943 and in 1942, to which you have previously testified, were not either sold at a gain or none sold at a loss, is that correct?

A. As far as I recall, that is correct, Mr. Hurley. I believe any property that was acquired back six or eight or ten years would be sold at a gain, the way things were on the market.

Q. I also ask you whether the properties acquired [40] which were sold and on which there were not several months intervening between the acquisition and sale were not sold at a gain.

A. There is one little particular property there with \$40.00 profit, or \$48.00 profit, whatever it is, it isn't anything to speak of.

Q. I simply asked the question whether any of the properties were sold at a loss. A. No.

Q. They were not? A. No, they were not.

Q. Mr. Field, referring again to your 1943 return and Schedule B attached thereto, you will notice the column headed selling expense and additional costs? A. Yes.

Q. In which are set forth various amounts which represent selling expense and additional costs on the sale of these various properties made in 1943. Can you tell the Court what the item listed opposite each property actually represents?

A. I had the bookkeeper get that——

(Testimony of Eddy D. Field.)

Mr. Bouchard: Talk a little louder, please.

The Witness: I had the bookkeeper get that for me. That was what you requested, I believe, in your letter. [41]

Q. Yes, that is correct.

A. It must be over in the place there. Just a minute. Here you are.

Q. That represents a breakdown of it?

A. Each profit you are asking about as it was returned on the tax.

Q. Now, the item——

The Court: What are you referring to, Mr. Hurley?

Mr. Hurley: If your Honor please, I am referring to the schedule attached to the 1943 return.

The Court: Is that going to be intelligible in the record?

Mr. Hurley: It should be. It is in this exhibit by years and dates, and I think I have identified the fact I am referring to this particular schedule. Let the record show I am now referring to the South La Jolla property as shown under item "Long Term Capital Gains and Losses" in Schedule B for 1943 Income Tax Return of Eddy B. Field.

Q. (By Mr. Hurley): Now, you have under the column "Selling Expense and Additional Expense" the item \$409.66. Do you have a breakdown of that item? A. It is right here, from here up.

Q. All right. Mr. Field, do you have in your notes there the amount that you realized on the

(Testimony of Eddy D. Field.)

rental of the properties [42] during the taxable year 1943? A. No, I don't.

Q. That amount is set forth in your 1943 return, is that correct? A. That is right.

Q. And is the amount that you realized on the sale of properties during the taxable year 1943 likewise reflected correctly on your return?

A. That is right. There was one exception, I believe—no, that was 1942. That is okeh. That is right.

Mr. Hurley: I have no further questions.

Mr. Bouchard: Just one more, please.

Redirect Examination

By Mr. Bouchard:

Q. Mr. Field, when Mr. Hurley was asking you about these 1944 sales, you told him that you could tell him why those properties were sold. Tell me. I would like to know.

A. I think the first one was on Garfield. That was a duplex I bought in 1943. I bought that for my sister, who was engaged at the time and I thought was going to be married, and we were going to rent it to her. However, it didn't pan out that way, and I sold it, because that is the only property—Glendale is quite a ways from my operation. And now the other one is, may I see the list? Normandie. I believe it was Gramercy, 801 Gramercy. I bought a half interest in that and [43] the partner that I had, it was either a case of buy or sell, and I had to sell. Unfortunately I might say

(Testimony of Eddy D. Field.)

too, we did not get along. 1173 Highland was bought in 1940. 739 Normandie, we sold that one because that happened to be in a district that was not the type of property we wanted. It was almost a red light district, or whatever you want to call it.

Mr. Hurley: Mr. Bouchard, the witness is not testifying now to the properties I examined him on. These properties are the 1944 sales. Here is his schedule.

Mr. Bouchard: I thought that is what you examined him on.

Mr. Hurley: No, those were properties simply summarized. These are the properties I examined him on.

Mr. Bouchard: Well, as I understand the Court's ruling, the Court has admitted evidence beyond the date in 1944. Now, I want to show why he sold those properties in 1944.

Mr. Hurley: I am not objecting, your Honor. I am simply saying to Mr. Bouchard that you won't recognize on the record the properties which the petitioner is testifying to, because they are in the record as having been sold in the year 1944, and he simply testified as to the gross amount of sales and profit on properties sold and the addresses were not established. [44]

Q. (By Mr. Bouchard): Mr. Field, you have been testifying in answer to my last questions about properties that you sold in 1944, is that correct?

A. That is right.

(Testimony of Eddy D. Field.)

Q. What other properties were sold in 1944, and give us the reason why you sold them.

A. 3220 Glendale was bought in 1932. We had a half interest in the thing, if I am not mistaken, and sold it in June of 1944, twelve years later. The party that bought this property was renting the property at the time and he kept after us to sell it to him, because he owned the corner and wanted this to tie in with his corner. It happened to be an old home on a business lot next to a Standard Oil Station, and he was leasing it or owned the property and was handling Standard Oil gasoline, and he wanted to increase the width of the opening to his lot and he asked us if we would sell it. At no time was it offered for sale, however. 3827 Coolidge was bought in 1940 and sold in 1944. That was a little house that we had down there, and I don't know exactly, the dates are not on here exactly, Mr. Bouchard.

Q. Is there any of that property that was sold in 1944 that you recall the reason for disposing of it, any particular reason?

A. I believe this Garfield, the duplex I bought for my sister in 1943 instead of 1944, and we got rid of it when she [45] didn't get married. 801 Gramercy, unfortunately we owned a one-half interest there with another party, and it didn't work out. And now the 1173 Highland, I kept that from 1940 to 1944. I imagine the reason we sold that was to get better rental income therefrom, as far as I

(Testimony of Eddy D. Field.)

know. That was only a duplex. Normandie we sold exactly for the reason I told you. It was not the district, when we first bought it we bought on account of it being close to Eighth Street in there. It might be all right, but it didn't pan out, it was not—we would have trouble down there with a different type of tenants.

Q. Was there any of those properties in the years we are talking about, 1942, '43 and '44, that you bought for any purpose other than securing a rental income? A. Not one, no, sir.

Mr. Bouchard: I think that is all.

Mr. Hurley: May I ask one or two further questions?

Recross-Examination

Q. (By Mr. Hurley): Is that likewise true of the properties that you sold in 1943?

A. That is right.

Q. Is it true of the properties that you previously testified to, 626 West Seventh Street—626 West Seventeenth Street, which you acquired on June 23, 1943 and sold on June 23, 1943? [46]

A. Mr. Hurley, will you be more clear. I told you that we went to escrow in May or something like that.

Q. I understand that.

A. Now then, when the Commodore came up, we acquired that July 1st, so before July we were acquiring and getting the deal there, because the

(Testimony of Eddy D. Field.)

Commodore, which is the Commodore Apartments at 1830 North Park, this big Commodore Apartment house, was the kind we had always been looking for to invest in and to keep, and we sacrificed the rest of the property for that. This is one of them.

Q. When you bought the property at 424 Kings Road on February 24, 1943, and sold it on March 24th, did you mean to keep that property for rental purposes?

A. I did. I will tell you what happened there. I had made a prior commitment on that property——

Mr. Bouchard: Speak a little louder.

The Witness: I had made a prior commitment to purchase property on that particular deal and we went to escrow, and as I told you we went to escrow the 24th of February, I believe it must have been the date, and about that same time it came about that we had the opportunity to buy the Commodore after that.

Q. (By Mr. Hurley): When you bought the property at 526 Harper January 9, 1943, and sold it February 26, 1943, you also bought [47] that for rental purposes, is that right?

A. That is right.

Q. When you bought that property on June 6, and sold it on July 6, 1943, that was bought with the idea of renting it, is that right?

A. No, the deal I told you before, I was buying that for my mother-in-law and my sister-in-law.

(Testimony of Eddy D. Field.)

Q. Then you didn't intend to rent that?

A. No, that was for her.

Q. When you bought on February 20, 1942 the Point View property and sold it on March 23, 1943, you also had intended to rent that one?

A. That is right.

Q. And when you bought the Manning property on October 1, 1943 and sold it November 1, 1943, you also intended to rent that when you bought it, is that right?

A. That is right.

Mr. Hurley: I have no further questions.

The Court: Mr. Field, as I understand, your objective has been to acquire a property with a large number of units.

The Witness: That is right.

The Court: And that was your objective a way back years ago, was it not?

The Witness: Yes, sir, back in — [48]

The Court: And these smaller properties, as I understand it, you bought because they were the only ones that you had money enough to buy.

The Witness: To handle.

The Court: To handle. So wasn't it your idea that as you could get the larger unit that you were going to dispose of those properties and buy a larger unit with the money?

The Witness: That was the purpose of it.

The Court: That was the purpose. So these properties were bought, as I understand your testimony, with the idea of selling and acquiring money to buy a larger unit.

(Testimony of Eddy D. Field.)

The Witness: That is right.

The Court: And you would have still a property that would help carry itself.

The Witness: Well, we bought——

The Court: With the rentals, as I understand your testimony, and you would if you could get a good price sell it.

The Witness: We would sell it, your Honor, to get another piece of property with a larger income. We kept crawling up and up as far as we could.

The Court: In other words, these smaller properties were bought with the idea of resale until you eventually had money enough to swing a big deal. [49]

The Witness: No.

The Court: Wasn't that the way you operated?

The Witness: No. We bought the properties first because—for instance, 330 La Brea, we bought it for a thousand dollars down, 1248 La Jolla, a thousand dollars down. We assumed heavy loans, then from the rental of the property we increased our equities and by the money that was made in the real estate brokerage business we increased the equities, and the ultimate idea was to buy if possible a large apartment house, and we have tried to keep the ones we had, we had a lot of little duplexes that we had to sell when we got the Cherokee because when we went to buy the Cherokee we didn't have the money to do it.

The Court: In other words, you were not saving your money and putting it in the bank, but your

(Testimony of Eddy D. Field.)

method of operation, as I understand it, was to keep your money employed in buying small places until you found the Cherokee?

The Witness: That is right, exactly.

The Court: And to sell this property so that you would have enough money to pay for what you wanted?

The Witness: That is correct.

The Court: Is that it?

The Witness: That is correct.

Mr. Hurley: May I ask a question there? [50]

Q. (By Mr. Hurley): What year was the Cherokee purchased? A. July 1, 1943.

Q. What date was any other large income producing property purchased? I mean the property that you have said you were eventually aiming at purchasing? Was Cherokee the only such purchase?

A. No, the Normandie, we purchased that——

Q. Where was that?

A. That was 739 South Normandie. We wanted to get large income properties under one management and have a better return with what we had to operate with.

Q. In other words, you started out on a shoe string and you had to buy and sell properties and make a profit on them until you could, so to speak, parlay your shoe string into a sufficient amount of money to purchase a large apartment unit, is that right? A. No, not actually.

Q. In what respect isn't that correct?

A. Mr. Hurley, I tried to tell you what the idea

(Testimony of Eddy D. Field.)

was. Remember the condition of the times we were in and what it was when we started our operation a way back. We would buy a house and put up fifteen hundred or a thousand dollars down and then sell it to get a duplex or a four unit and pay off the mortgage with the rental money. Our ultimate purpose was to get a big apartment building, and we figured when we got [51] the Cherokee that was it. Yesterday I had a man come to me out of the clear sky and offer me half a million dollars for it. I turned that down. I have turned down dozens of offers on it.

Q. But the point is that the money that you hoped to acquire the big unit with is the money that you received from the sale of those properties, isn't that correct?

A. No. In 1943 I made \$76,000.00 gross commission from the sale of real estate, I believe it was seventy-six or something like that gross commission. We sold one hundred and fifty-eight pieces of property and we collected five per cent or whatever we got on it. I took in around seventy thousand dollars.

Q. Then you didn't need any more capital in order to purchase an apartment unit if you were making out so well in your regular business.

A. I beg to differ with you. Our money was invested in equities instead of keeping it in the bank. I was in hopes of buying a large apartment and it was just out of the clear sky I happened to get that one.

(Testimony of Eddy D. Field.)

Q. Where did you expect to get the money to buy that large apartment?

A. When the opportune time came to buy?

Q. Yes.

A. Then we would sell those equities to get it. That [52] is what.

Mr. Hurley: No further questions.

Mr. Bouchard: That is all.

The Court: Step down. We will take a five minute recess.

(Witness excused.)

(Short recess taken.)

The Court: Proceed.

Mr. Bouchard: Now, if your Honor please, I think there is only one thing more. I understand you wanted to put in the tax returns for 1942 and 1943.

Mr. Hurley: Yes.

Mr. Bouchard: I believe we had a stipulation at the outset that the computation of profit is correct and is as shown on the tax returns, is that correct?

Mr. Hurley: Well, the gross entirely, not the capital gain.

Mr. Bouchard: Yes. Will you offer those returns, Mr. Hurley?

Mr. Hurley: All right. At this time I would like to offer in evidence as Respondent's Exhibit C the individual income tax return of Eddy B. Field for the year 1942, and as Exhibit D the individual income tax return of Eddy B. Field for the year 1943, and as Exhibit E the tax return of the peti-

tioner Helen Field for the year 1942 and as Respondent's [53] Exhibit F the tax return for the same taxpayer for the year 1943.

The Court: They may be received. What is the 1942, the forgiveness year?

Mr. Hurley: Yes, your Honor.

(The documents above referred to were received in evidence and marked Respondent's Exhibits C, D, E and F.)

Mr. Bouchard: Yes. With that Petitioner rests, your Honor.

Mr. Hurley: Respondent rests.

The Court: That closes the record as far as the taking of testimony is concerned. I suppose you will want to brief it?

Mr. Hurley: Yes.

The Court: We will have briefs under the rule, 45 days and 20 days for any reply. Mr. Clerk, suppose you give them the dates.

The Clerk: That will be December 3rd; reply date December 23rd.

The Court: Is that all?

Mr. Bouchard: Yes, your Honor.

The Court: That is all.

(Whereupon, at 11:45 o'clock a.m. Tuesday, October 19, 1948, the hearing in the above-entitled matter was closed.)

EXHIBIT C

INCOME TAX RETURN CALENDAR YEAR 1942

Eddy D. Field, 1019 South La Brea Avenue, Los Angeles, Calif.

Line 1

Revenues

Commissions Received	\$46,270.60✓
Commissions on Rentals.....	2,417.32✓
Commissions on Insurance.....	769.47✓
Commissions Handling Property Management.....	2,215.12✓
Commissions on Property Maintenance.....	215.10✓
Discounts Earned	151.46✓

Total	52,039.07
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Less—Commissions Paid other Brokers..\$451.75✓

Commissions Paid other

Rental Apt. 55.00✓

Commissions Paid on loan

Negotiation 10.00✓

Misc. Costs on Property

Maintenance 228.81✓

745.56

Item 1 \$51,293.51

EXHIBIT C—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1942

Eddy D. Field, 1019 South La Brea, Los Angeles, Calif.

Schedule B

Rents Received

Name of Building	Amount
1017 South La Brea.....	\$ 750.00
✓6282 Commodore Slodt	1,188.66
1639 North Gower	775.00✓
1032 Redondo	6,900.19
Baker Apts.	18,295.27✓
✓900 So. Kenmore	6,387.63
6016 Whitworth	3,424.16✓
✓2646 Vineyard	1,980.00✓
✓1315 Roxbury	843.75✓
✓1108 Longwood	110.00✓
✓1248 So. La Jolla.....	2,090.00✓
338 North La Brea.....	3,023.78✓
1195 La Brea (sign).....	35.00
La Brea & Edgewood (sign).....	30.00
✓1144 South Hi Point.....	720.00✓
✓1173 South Highland	1,440.00
Crestline Garage	302.50
• 301 North Croft	1,350.00✓
✓300 South Clark.....	1,505.00✓
Total	<u><u>\$51,150.94✓</u></u>

EXHIBIT C—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1942

Eddy D. Field, 1019 South La Brea Avenue, Los Angeles, Calif.

Schedule B

	Column 5 Line 1	Deductions Item 17
Salaries Managers		
Office—General	\$ 4,816.76✓	\$ 3,163.88✓
Commissions	159.80✓	23,699.59✓
Outside Rental Commissions.....	30.00 (Out)†	
Overriding Commission		2,760.04✓
Payroll Taxes	136.50✓	1,031.36✓
Heat, Light, Water and Power.....	4,132.19✓	114.74✓
Stationery and Office Supplies.....	37.84✓	399.03✓
Janitor Supplies	84.97✓	45.10✓
Postage		202.00✓
Telephone	119.75✓	1,769.50✓
Repairs		207.19✓
Rent		740.00✓
Taxes, Real and Personal.....	6,175.87✓	382.04✓
Licenses	46.80✓	58.00✓
Insurance	1,442.34✓	434.17✓
*Interest Paid	7,253.85✓	142.38✓
Advertising—Newspaper	6.72✓	3,050.21✓
Signs	1.03✓	197.71✓

*See Schedule attached.

EXHIBIT C—(Continued)

	Column 5 Line 1	Deductions Item 17
Automobile		1,279.72—1002.02†
Travel and Entertainment.....		304.05— 290.91†
Membership—Dues		238.50✓
Legal and Auditing.....		460.84✓
Donations		215.87✓
Realty Service		127.80✓
Laundry		6.64✓
Service Charges		198.43✓
Air Raid Protective Expense.....		
Sales Promotion		354.92✓
Gardening Supplies		+7.83 — 7.43✓
		<u> </u>
Total Expenses	\$26,240.81	<u>\$41,609.14</u>
		<u> </u>
		+295.70
		<u>13.14</u>
		<u>308.44</u>
		<u>40</u>
		<u>308.84</u>

†The above calculations are in pencil at the bottom of return.

EXHIBIT C—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1942

Eddy D. Field, 1019 South La Brea Avenue, Los Angeles, Calif.

Schedule B

Line 2

	Berryman Coolidge	3270 Glendale Blvd.	
Rents Received	\$862.01	\$360.00	
Expenses			
Interest	316.61	73.70	
Taxes	176.33	133.81	
Repairs			
Plumbing	4.00		
Painting & Wallpaper.....	170.50		
Carpentry	27.50		
Miscellaneous	56.05		
Repair Venetian Blind.....	9.60		
Insurance	6.30		
Total Expenses	766.89	207.51	
Net Gain	95.12	152.49	
Eddy D. Field—Taxpayer, has a one-half interest only	\$ 47.56	\$ 76.25	\$123.81

EXHIBIT C—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1942

Eddy D. Field, 1019 South La Brea Avenue, Los Angeles, Calif.

Interest Paid

Schedule of Explanation for Expense Schedule

Name	Amount	*Adm. Ins.
Chas. W. Baker.....	\$1,289.01	
Security 1st National (Carthay).....	242.21	
Security 1st National (Beverly).....	45.56	
Bank of America (7th & Spring).....	301.94	
Bank of America (7th & Spring).....	135.03	
Bank of America (West Adams).....	829.23	
Provident Mutual Life Insurance.....	40.50	
Marion C. Brown.....	201.24	
Western Service Corporation.....	414.75	
H. F. Whittle Investment Co.....	234.82	
John Hancock Mutual Like.....	1,543.59	
Prudential Insurance Co.....	445.31	
Mary E. Brown.....	69.05	
Wm. B. Himrod.....	13.76	
Gussie A. Booker.....	587.26	
Pacific Mutual Life Insurance.....	664.64	
Mutual Life Insurance Company.....	195.95	
Total.....	<u>\$7,253.85</u> ✓	<u>142.38*</u>

*This column is written in pencil.

1942 INCOME TAX RETURN

Eddy D. Field, 1019 So. La Brea Ave., Los Angeles, Calif.

Schedule J

Kind	Date Acquired	Cost	Depreciation Prior	Remaining Cost	Life	Remaining Depreciation 1942 Life
Crestline Garage	2/ 1/40	1,500.00	143.75	1,356.25	20	18 75.00
1172 So. Highland—Frame stucco....	1/ 2/41	7,493.35	299.73	7,193.62	25	24 299.73
1030 Redondo (bldg.)—Frame stucco	6/15/41	15,078.56	216.13	14,862.38	33 ¹ / ₃	32 ¹ / ₃ 452.36
1032 Redondo (Furn. & Refrig.)	6/15/41	6,359.87	317.99	6,041.88	10	9 635.98✓
900 So. Kenmore—Frame stucco.....	9/ 6/41	22,522.91?	168.92	22,353.99	33 ¹ / ₃	32 ¹ / ₃ 675.68
300 So. Clark—Frame stucco.....	1/ 1/42	7,500.00?	.....	7,500.00 ✓	25	24 300.00
341 No. Croft—Frame stucco.....	1/ 1/42	5,250.00	.....	5,250.00	20	19 262.50
1144 So. Hi Point—Frame stucco....	1/ 1/42	4,000.00	.....	4,000.00	20	19 200.00
338 ¹ / ₂ No. LaBrea—Frame stucco.....	1/ 1/42	11,000.00	.....	11,000.00	20	19 550.00
1248 So. La Jolla—Frame stucco.....	1/ 1/42	11,750.00	.....4	11,750.00	25✓	24 470.00
2646 Vineyard—Frame stucco.....	1/ 1/42	8,500.00	.....	8,500.00	20	19 425.00
6016 Whitworth—Frame stucco.....	1/ 1/42	14,500.00	.....	14,500.00	20	19 725.00
Baker Apts.—Brick frame stucco.....	1/ 1/42	29,000.00	.....	29,000.00	25	24 1,160.00
Baker Apts. (Furn. and linens).....	1/ 1/42	6,000.00	.....	6,000.00	6	5 1,000.00✓
3826 Berryman (1 ¹ / ₂ interest).....	1940	3,150.00 ¹ / ₂	52.50	3,097.50	30	29 52.50 ¹ / ₂ ✓
3827 Coolidge (1 ¹ / ₂ interest).....	1940	3,150.00 ¹ / ₂	52.50	3,097.50	30	29 52.50 ¹ / ₂ ✓
3270 Glendale (1 ¹ / ₂ interest).....	1936	1,500.00 ¹ / ₂	187.50	1,125.00	20	14 37.50 ¹ / ₂ ✓
6282 Commodore Sloat—Frame stucco	8/29/42	13,750.35	.....	13,750.00	25	15 2 mo. 91.66
6282 Commodore Sloat—Furniture...	8/29/42	3,362.45	.....	3,362.45	6	6 2 mo. 93.40✓
1019 So. La Brea Ave.—R. E. Office..	7/ 1/41	6,744.42	337.22	6,407.20	10	9 674.44✓
R. E. Office Furniture4						
1019 So. La Brea.....	7/ 1/41	2,757.27	137.86	2,619.41	10	9 275.72✓
1939 Cadillac for Business.....	2/ 1/39	2,768.07	2,018.39	749.68	4	.... 692.02✓

Notation 5686.93 in righthand margin initialed M. C.

Total Depreciation.....

\$9,141.59

EXHIBIT D

INCOME AND VICTORY TAX RETURN REQUIREMENTS

An income and victory tax return must be filed with the United States Collector of Internal Revenue for the district in which you live, on or before March 15, 1944, if you are a single person or a married person not living with husband or wife, and if the total payments reported on this form when added to your income from all other sources amount to \$500 or more.

If you are a married person living with husband or wife, a return must be filed if the total payments reported on this form when added to your income from all other sources amount to \$624 or more, or if the combined total income of husband and wife amounts to \$1,200 or more.

An Income and Victory Tax Return Form may be obtained from the collector of internal revenue for your district.

Optional Form 1040A may be filed if your gross income is not more than \$3,000 and is derived only from salary, wages, dividends, interest, and annuities; otherwise form 1040 should be filed.

EXHIBIT D—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1943

Eddy D. Field, 1019 S. La Brea Ave., Los Angeles, (35) Calif.

Item 1 Page 1

Revenues

Commissions Received Real Estate Sales.....	67,131.13✓
Commissions Received on Rentals.....	672.08✓
Commissions Received on Insurance Sales.....	1,655.51✓
Commissions Received on Property Management.....	1,540.75✓
Commissions Received on Property Management Extras..	280.74✓
Discounts Earned on Purchases.....	361.04✓
Miscellaneous Income	536.58✓
	<hr/>
	72,177.83✓
Less—Commissions Paid Other Brokers	551.25✓
Commissions on Loan Negotiations.....	18.00✓
Misc. Expenses on Commissions Earned....	492.67✓
	<hr/>
Item 1	71,115.91✓
	<hr/> <hr/>

EXHIBIT D—(Continued)

INSTRUCTIONS

(References are to the Internal Revenue Code)

GAINS AND LOSSES FROM SALES OR EXCHANGES OF CAPITAL ASSETS AND OTHER PROPERTY.—Report details in schedule on other side.

“Capital assets” defined.—The term “capital assets” means property held by the taxpayer (whether or not connected with his trade or business), but not stock in trade or other property of a kind which would properly be included in his inventory if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property used in the trade or business of a character which is subject to the allowance for depreciation provided in section 23 (1), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer.

Section 165 (b) provides that if an employee receives the total distribution that he is entitled to under an employees’ trust plan that meets the requirements of section 165 (a) in one taxable year on account of his separation from service, the amount of such distribution to the extent exceeding the amounts contributed by the employee shall be considered a gain from the sale or exchange of a capital asset held for more than 6 months.

A capital gain dividend, as defined in section 362 (relating to tax on regulated investment companies), shall be treated by the shareholder as gains from the sale or exchange of capital assets held for more than 6 months.

For special treatment of gains and losses from involuntary conversion, and from sale or exchange of certain property used in the trade or business, see section 117 (j).

Description of property.—State following facts: (a) For real estate, location and description of land and improvements; (b) for bonds or other evidences of indebtedness, name of issuing corporation, particular issue, denomination and amount; and (c) for stocks, name of corporation, class of stock, number of shares, and capital changes affecting basis (including nontaxable distributions).

Basis.—In determining GAIN in case of property acquired before March 1, 1913, use the cost or the fair market value as of March 1, 1913, adjusted as provided in section 113 (b), which-

EXHIBIT D—(Continued)

ever is greater, but in determining LOSS use cost so adjusted. If the property was acquired after February 28, 1913, use cost, except as otherwise provided in section 113.

Losses on securities becoming worthless.—If (1) shares of stock become worthless during the year or (2) corporate securities with interest coupons or in registered form become worthless during the year, and are capital assets, the loss therefrom shall be considered as from the sale or exchange of capital assets as of the last day of such taxable year.

Nonbusiness debts.—If a debt, other than a debt evidenced by a corporate security with interest coupons or in registered form and other than a debt the loss from the worthlessness of which is incurred in the trade or business, becomes totally worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. Enter such loss in column 10 of schedule of short-term capital gains and losses on other side.

Classification of capital gains and losses.—The phrase “short-term” applies to gains and losses from the sale or exchange of capital assets held for 6 months or less; the phrase “long-term” to capital assets held for more than 6 months.

LIMITATION ON CAPITAL LOSSES.—Losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus the net income (computed without regard to capital gains and losses) or \$1,000, whichever is smaller. However, a net capital loss as defined in section 117 (a) (11) for a taxable year beginning in 1942 may be carried over to the taxable year 1943 and treated as a short-term capital loss. The amount of the net short-term capital loss for a taxable year beginning in 1941 may not be included in computing the net capital loss for a taxable year beginning in 1942 which can be carried forward to a taxable year beginning in 1943.

ALTERNATIVE TAX.—If the net long-term capital gain exceeds the net short-term capital loss, an alternative tax may be imposed in lieu of the normal tax and surtax imposed on net income. (See Computation of Alternative Tax, on other side.)

“Wash sales” losses.—Loss from sale or other disposition of stocks or securities cannot be deducted unless sustained in connection with the taxpayer’s trade or business, if, within 30 days before or after the date of sale or other disposition, the taxpayer has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option to acquire, substantially identical stock or securities.

EXHIBIT D—(Continued)

Losses in transactions between certain persons.—No deduction is allowable for losses from sales or exchanges of property directly or indirectly between (a) members of a family, (b) a corporation and an individual owning more than 50 per cent of its stock (liquidations excepted), (c) a grantor and fiduciary of any trust, or (d) a fiduciary and a beneficiary of the same trust.

EXHIBIT D—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1943

Eddy D. Field, 1019 S. La Brea Ave., Los Angeles, (35) Calif.

Schedule C 1
Line 1 Column 2

Rents Received

Address of Property	Amount
859 South Wooster.....	1,495.11
631 East Garfield (Glendale, Calif.).....	107.00
1830 North Cherokee (Commodore Apartments).....	21,178.75
Crestline Garage	291.25
1639 North Gower✓	470.00
1173 Highland Avenue	1,340.00
338 North La Brea✓.....	3,300.57
801 South Gramercy Drive.....	15,031.40
6016 Whitworth	3,880.00
1032 South Redondo Blvd.....	7,949.44
845 West Olympic (Baker Apartments)✓.....	18,328.24
1019 South La Brea.....	300.00
4931 Venice Blvd.....	476.00
6282 Commodore Sloat Dr.....	2,004.86
2203 Beechwood	4,301.03
300 South Clark Drive	1,055.50
341 North Croft	562.50
1144 South Hi Point.....	448.00
900 North Kenmore.....	2,777.75
1248 La Jolla.....	799.25
2646 Vineyard	1,078.50
6439 Orange	600.57
Vacant Lot	24.00
Total Rents Received.....	87,799.72✓

EXHIBIT D—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1943

Eddy D. Field, 1019 S. La Brea, Los Angeles, (35), Calif.

	Schedule C 1 Column 5 Line 1	Deductions Item 16
Salaries—Mgrs. and Ass't. Mgrs.....	11,504.74✓	
Office		3,860.74✓
Commissions Paid	36.75✓	33,689.97✓
Overriding Commissions		4,788.40✓
Pay Roll Taxes	176.63✓	1,084.74✓
Outside Rental Commissions Paid	3.75✓	
Heat, Light, Power	8,069.98✓	118.80✓
Stationery and Office Supplies.....	22.47✓	980.04✓
Janitor Supplies	322.05✓	75.90✓
Postage		290.64✓
Telephone	526.76✓	2,002.53✓
Repairs		624.26✓
Rents Paid		780.00✓
Taxes (L. A. County Prop.).....	9,613.18✓ ok	388.93✓
Sales Tax		23.91✓
Licenses	71.00✓	25.00✓
Insurance	2,660.88✓	980.98✓
Interest Paid (See Schedule).....	11,121.18✓	437.06✓
Advertising—Newspapers	1.74✓	3,691.04✓
Signs		1.24✓
Auto Expense		569.85✓
Travel and Entertainment on Deals...		210.14✓
Membership Dues, Subscriptions		145.35✓
Legal and Auditing	628.15✓	315.00✓
Business Donations		454.84✓
Realty Service		202.00✓
Laundry	1,776.38✓	
Service Charges	1,693.32✓	265.88✓
Sales Promotion		472.53✓
Gardening Supplies	156.09✓	13.94✓
Supplies for Apartment Management..	106.67✓	
	<u>48,491.72</u>	<u>56,491.71</u>

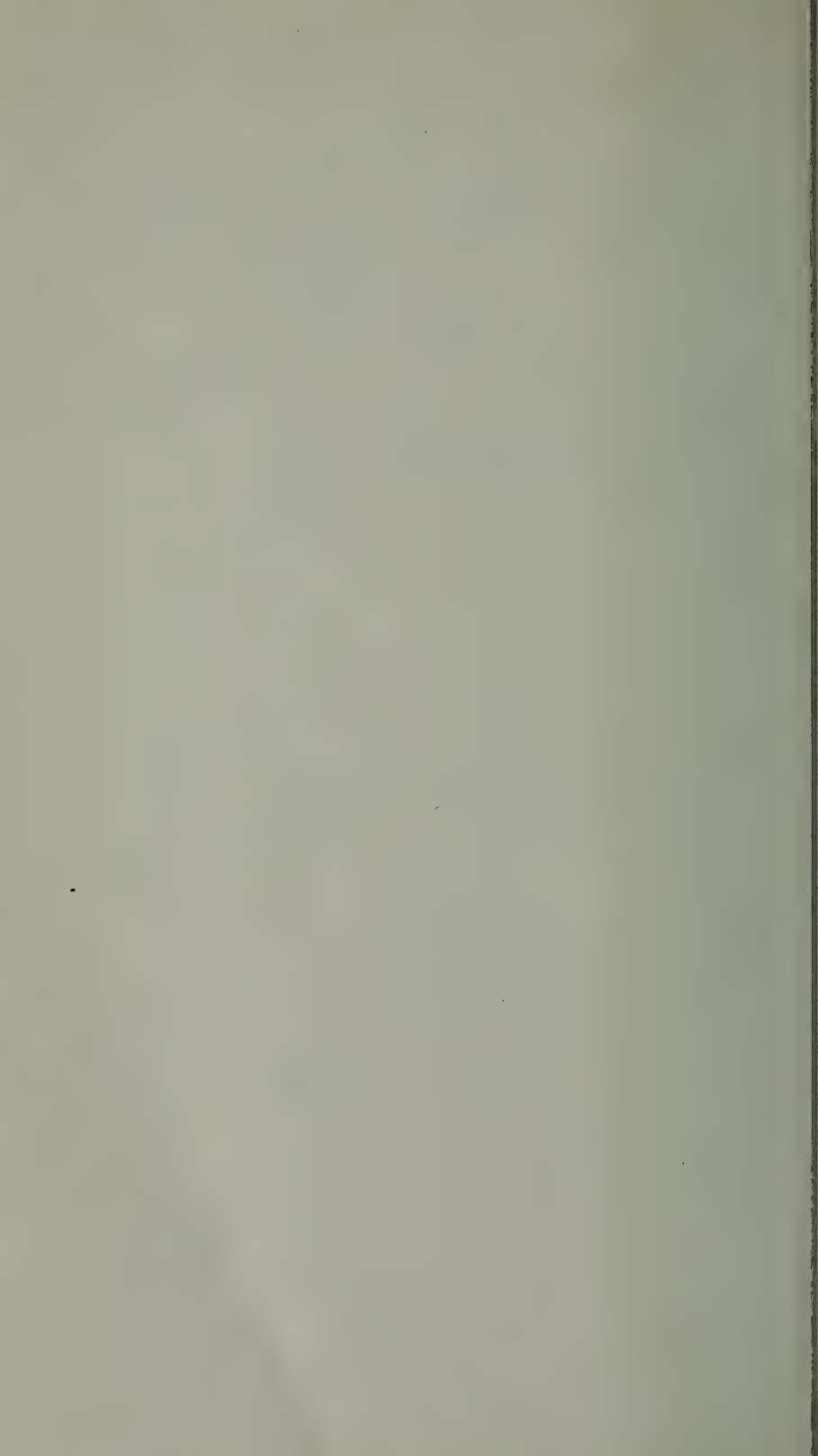


EXHIBIT D—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1943

Eddy D. Field, 1019 South La Brea, Los Angeles, (35) Calif.

Explanation of Depreciation

Description	Date Acquired	Cost of Building	Deprec. Prior Period	Remaining Cost	Life	Remaining Life	Deprec. 1943
Crestline Garage	2/ 1/40	1,500.00	218.75	1,281.25	20 yrs.	18 yrs.	75.00
1173 South Highland.....	1/ 2/41	7,493.35	599.46	6,893.89	25 yrs.	24 yrs.	299.73
1032 S. Redondo (Bldg.).....	6/15/41	15,078.56	668.54	14,410.02	33-1/3 yrs.	32-1/3 yrs.	452.36
1032 S. Redondo (Furn. & Equip.).....	6/15/41	6,359.87	953.97	5,405.90	10 yrs.	9-1/2 yrs.	635.98
338½ N. La Brea.....	1/ 1/42	11,000.00/	550.00	10,450.00	20 yrs.	19 yrs.	550.00
6016 Whitworth	1/ 1/42	14,500.00/	725.00	13,775.00	20 yrs.	19 yrs.	725.00
Baker Apartments (Bldg.).....	1/ 1/42	29,257.50/	1,160.00	28,097.50	25 yrs.	24 yrs.	1,170.30
Baker Apts. (Furn. & Linens).....	1/ 1/42	6,000.00/	1,000.00	5,000.00	6 yrs.	5 yrs.	1,000.00
739 S. Normandie (Bldg.).....	2/ 1/43	41,000.00	.....	41,000.00	25 yrs.	25 yrs.	1,503.33 (11 mos.)
739 S. Normandie (Furn.).....	2/ 1/43	7,500.00	.....	7,500.00	6-2/3 yrs.	6-2/3 yrs.	1,031.25 (11 mos.)
1830 N. Cherokee (Bldg.).....	7/ 1/43/	142,243.82	.....	142,243.82	25 yrs.	25 yrs.	2,844.88 (6 mos.)
1830 N. Cherokee (Furn. & Equip.).....	7/ 1/43/	21,030.78	.....	21,030.78	6-2/3 yrs.	6-2/3 yrs.	1,577.31 (6 mos.)
4921 Venice Blvd.....	8/24/43	6,431.11	.....	6,431.11	20 yrs.	20 yrs.	116.13 (4-1/3 mos.)
859 Wooster	7/15/43	17,212.60	.....	17,212.60	25 yrs.	25 yrs.	315.56 (5-1/2 mos.)
631 East Garfield (Glendale).....	11/19/43	4,963.09	.....	4,963.09	20 yrs.	20 yrs.	31.02 (1-1/2 mos.)
1019 S. La Brea, Real Estate Office.....	7/ 1/41	6,744.42/	1,011.66	5,732.76	10 yrs.	9 yrs.	674.44✓
1019 S. La Brea (Furn. & Fixtures).....	7/ 1/41	2,757.27	413.58	2,343.69	10 yrs.	9 yrs.	275.73✓
1939 Cadillac Sedan (Bus. Car).....	2/ 1/39	2,768.07	2,710.41	57.66	4 yrs.	1 mo.	57.66✓
1942 Ford Coupe (Bus. Car).....	6/30/43	1,741.91	.....	1,741.91	4 yrs.	4 yrs.	217.74✓
3826 Berryman (½ Interest).....	1940 (½)	3,150.00	105.00	3,045.00	30 yrs.	28 yrs.	52.50 (1/2)✓
3827 Coolidge (½ Interest).....	1940 (½)	3,150.00	105.00	3,045.00	30 yrs.	28 yrs.	52.50 (1/2)✓
3270 Glendale (½ Interest).....	1936 (½)	1,500.00	225.00	1,275.00	20 yrs.	13 yrs.	37.50 (1/2)✓
801 S. Gramercy (Bldg.) (½ Interest).....	10/10/43	65,588.78	.....	65,588.78	50 yrs.	50 yrs.	291.44 (1/2)✓
801 S. Gramercy (Furn.) (½ Interest).....	10/10/43	7,915.88	.....	7,915.88	10 yrs.	10 yrs.	175.90 (1/2)✓
744 North Ogden (½ Interest).....	11/26/43 (½)	2,003.69	.....	2,003.69	20 yrs.	20 yrs.	8.35 (1/2)✓

Notation—Figs. 4244.54 and illegible initials appear on right margin of sheet.

TOTAL..... 14,171.61

EXHIBIT D—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1943

Eddy D. Field, 1019 S. La Brea, Los Angeles, (35) Calif.

Schedule C 1

Line 2

Revenues and Expenses on Properties Owning $\frac{1}{2}$ Interest Only

	Berryman Coolidge	3270 Glendale Blvd.	801 South Gramercy	Totals
Rents Received.....	912.00	360.00	5,660.18	
Expenses:				
Wages			1,256.92	
Heat, Light and Water..			589.02	
Stationery			1.37	
Janitor Supplies			20.80	
Postage			1.50	
Telephone			19.01	
Laundry			330.74	
Rent of Parking Lot			20.00	
Service Charges			90.44	
Interest	288.68	149.91	1,377.37	
Taxes	167.06	108.93		
Insurance	6.30	41.70		
Miscellaneous		8.92		
Repairs (Building)	15.66		79.63	
Equipment			222.14	
Total Expenses.....	477.70	309.46	4,008.94	
Net Gain	434.30	50.54	1,651.24	2,136.08
One-half Interest in Gain Reported Schedule C 1, Line 2.....				1,068.04

Note: Depreciation taken in Depreciation Schedule at one-half, and charged against revenues all properties.

EXHIBIT D—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1943

Eddy D. Field, 1019 S. La Brea, Los Angeles, (35) Calif.

Schedule of Interest Paid

To Whom	Property	Mortgage Int.	Admin. Interest
Marvin E. Brown.....	1639 North Gower.....	121.00	
Syndicate Mortgage.....	739 South Normandie.....	1,542.66	
Western Service Corp'n.....	1173 South Highland.....	418.79	
Prudential Ins. Co.....	338 North La Brea.....	450.57	
Pacific Mutual Life Ins.....	1032 South Redondo.....	613.02	
Belmont Co.....	6016 Whitworth.....	634.99	
Belmont Co.....	2203 Beechwood.....	753.67	
Ralph Sutro.....	859 South Wooster.....	340.76	
Fred W. Heatherly.....	Lot #144, Tr. 7170.....	115.50	
Charles Baker.....	845 West Olympic.....	764.04	
M. E. and E. E. Ringemann.....	1830 North Cherokee.....	3,404.49	
Security 1st Nat'l. Bank.....	300 South Clark.....	144.83	
Security 1st Nat'l. Bank.....	300 South Clark.....		22.22
Provident Mutual.....	6282 Commodore Sloat Dr.....	250.49	
Provident Mutual.....	6282 Commodore Sloat Dr.....		30.43
Bank of America.....	341 North Croft.....	83.84	
Bank of America.....	338 North La Brea.....	70.18	
Bank of America.....	2646 Vineyard.....	290.58	

EXHIBIT D—(Continued)

To Whom	Property	Mortgage Int.	Admin. Interest
H. F. Whittle Inv. Co.....	1144 Hi Point.....	160.53	
John Hancock Mutual Life.....	900 South Kenmore.....	533.35	
Gussie Booker	1248 La Jolla.....	215.58	
Clifford K. Steele.....	Palisades Lot	2.73	
Mortgage Guarantee	1248 S. La Jolla.....	141.46	
Mortgage Guarantee	744 N. Ogden.....	6.88	
Joe Endemiller	739 South Normandie.....	75.00	43.74
Joe Endemiller	739 South Normandie.....		77.99
Mutual Life Ins. Co.....			260.27
Martha Sinclair			2.41
Collector of Internal Revenue.....			
	Total Interest Paid.....	11,121.18	437.06

EXHIBIT E

INCOME TAX RETURN CALENDAR YEAR 1942

Helen Field, 1019 South La Brea Avenue, Los Angeles, Calif.

Line 1

Revenues

Commissions Received	\$46,270.60
Commissions on Rentals.....	2,417.32
Commissions on Insurance.....	769.47
Commissions Handling Property Management.....	2,215.12
Commissions on Property Maintenance.....	215.10
Discounts Earned	151.46

Total.....	52,039.07
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Less—Commissions Paid other Brokers.....	\$451.75
Commissions Paid other Rental Apt.	55.00
Commissions Paid on Loan	
Negotiation	10.00
Misc. Costs on Property	
Maintenance	228.81

745.56

Item 1.....	\$51,293.51
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EXHIBIT E—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1942

Helen Field, 1019 South La Brea, Los Angeles, Calif.

Schedule B

Rents Received

Name of Building	Amount
1017 South La Brea.....	\$ 750.00
6282 Commodore Slodt.....	1,188.66
1639 North Gower	775.00
1032 Rendondo	6,900.19
Baker Apts.	18,295.27
900 South Kenmore.....	6,387.63
6016 Whitworth	3,424.16
2646 Vineyard	1,980.00
1315 Roxbury	843.75
1108 Longwood	110.00
1248 So. La Jolla.....	2,090.00
338 North La Brea.....	3,023.78
1195 La Brea (sign).....	35.00
La Brea & Edgewood (sign).....	30.00
1144 South Hi Point.....	720.00
1173 South Highland	1,440.00
Crestline Garage	302.50
301 North Croft	1,350.00
300 South Clark	1,505.00
Total.....	<u><u>\$51,150.94</u></u>

EXHIBIT E—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1942

Helen Field, 1019 South La Brea Avenue, Los Angeles, Calif.

Schedule B

	Column 5 Line 1	Deductions Item 17
Salaries Managers	\$ 4,816.76	\$
Office—General		3,163.88
Commissions	159.80	23,699.59
Outside Rental Commissions.....	30.00	
Overriding Commission		2,760.04
Pay Roll Taxes	136.50	1,031.36
Heat, Light, Water and Power.....	4,132.19	114.74
Stationery and Office Supplies.....	37.84	399.03
Janitor Supplies	84.97	45.10
Postage		202.00
Telephone	119.75	1,769.50
Repairs		207.19
Rent		740.00
Taxes, Real and Personal.....	6,175.87	382.04
Licenses	46.80	58.00
Insurance	1,442.34	434.17
*Interest Paid	7,353.85	142.38
Advertising—Newspaper	6.72	3,050.21
Signs	1.03	197.71
Automobile		1,297.72
Travel and Entertainment.....		304.05
Membership—Dues		238.50
Legal and Auditing	93.45	460.84
Donations	45.00	215.87
Realty Service	20.83	127.80
Laundry	383.22	6.64
Service Charges	1,231.09	198.43
Air Raid Protective Expense.....	45.86	
Sales Promotion		354.92
Gardening Supplies	18.60	7.43
Total Expenses	<u>\$26,240.81</u>	<u>\$41,609.14</u>

*See Schedule attached.

EXHIBIT E—(Continued)

INCOME RETURN CALENDAR YEAR 1942

Helen Field, 1019 South La Brea Avenue, Los Angeles, Calif.

Schedule B

Line 2

	Berryman Coolidge	3270 Glendale Blvd.	
Rents Received	\$862.01	\$360.00	
Expenses			
Interest	316.61	73.70	
Taxes	176.33	133.81	
Repairs			
Plumbing	4.00		
Painting & Wallpaper.....	170.50		
Carpentry	27.50		
Miscellaneous	56.05		
Repair Venetian Blind.....	9.60		
Insurance	6.30		
Total Expenses	766.89	207.51	
Net Gain	95.12	152.49	
Eddy D. Field—Taxpayer, has a one-half interest only.....	\$ 47.56	\$ 76.25	\$123.81

EXHIBIT E—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1942

Helen Field, 1019 South La Brea Avenue, Los Angeles, Calif.

Interest Paid

Schedule of Explanation for Expense Schedule

Name	Amount
Chas. W. Baker	\$1,289.01
Security 1st National (Carthay).....	242.21
Security 1st National (Beverly).....	45.56
Bank of America (7th & Spring).....	301.94
Bank of America (7th & Spring).....	135.03
Bank of America (West Adams).....	829.23
Provident Mutual Life Insurance.....	40.50
Marion C. Brown.....	201.24
Western Service Corporation.....	414.75
H. F. Whittle Investment Co.....	234.82
John Hancock Mutual Life.....	1,543.59
Prudential Insurance Co.....	445.31
Mary E. Brown.....	69.05
Wm. B. Himrod.....	13.76
Gussie A. Booker	587.26
Pacific Mutual Life Insurance.....	664.64
Mutual Life Insurance Company.....	195.95
Total.....	<u>\$7,253.85</u>

EXHIBIT E—(Continued)

1942 INCOME TAX RETURN

Eddy D. Field, 1019 So. La Brea Ave., Los Angeles, Calif.

Schedule J

Kind	Date Acquired	Cost	Depreciation Prior Cost	Life	Remaining Depreciation Life	1942
Crestline Garage	2/ 1/40	1,500.00	143.75	20	18	75.00
1173 So. Highland—Frame stucco.....	1/ 2/41	7,493.35	299.73	25	24	299.73
1032 Redondo (bldg.)—Frame stucco	6/15/41	15,078.56	216.18	33 $\frac{1}{3}$	32 $\frac{1}{3}$	452.36
1032 Redondo (Furn. & Refrig.).....	6/15/41	6,359.87	317.99	10	9	635.98
900 So. Kenmore—Frame stucco.....	9/ 6/41	22,522.91	168.92	33 $\frac{1}{3}$	32 $\frac{1}{3}$	675.68
300 So. Clark—Frame stucco.....	1/ 1/42	7,500.00	.....	25	24	300.00
341 No. Croft—Frame stucco.....	1/ 1/42	5,250.00	.....	20	19	262.50
1144 So. HiPoint—Frame stucco.....	1/ 1/42	4,000.00	.....	20	19	200.00
338 $\frac{1}{2}$ No. LaBrea—Frame stucco.....	1/ 1/42	11,000.00	.....	20	19	550.00
1248 So. LaJolla—Frame stucco.....	1/ 1/42	11,750.00	.....	25	24	470.00
2646 Vineyard—Frame stucco.....	1/ 1/42	8,500.00	.....	20	19	425.00
6016 Whitworth—Frame stucco.....	1/ 1/42	14,500.00	.....	20	19	725.00
Baker Apts.—Frame stucco.....	1/ 1/42	29,000.00	.....	25	24	1,160.00
Baker Apts. (Furn. and linens).....	1/ 1/42	6,000.00	.....	6	5	1,000.00
3826 Berryman ($\frac{1}{2}$ interest).....	1940	3,150.00 $\frac{1}{2}$	52.50	30	29	52.50 $\frac{1}{2}$
3827 Coolidge ($\frac{1}{2}$ interest).....	1940	3,150.00 $\frac{1}{2}$	52.50	30	29	52.50 $\frac{1}{2}$
3270 Glendale ($\frac{1}{2}$ interest).....	1936	1,500.00 $\frac{1}{2}$	187.50	20	14	37.50 $\frac{1}{2}$
6282 Commodore Sloat—frame stucco	8/29/42	13,750.35	.....	25	15 2 mo.	91.66
6282 Commodore Sloat—Furniture....	8/29/42	3,362.45	.....	6	6 2 mo.	93.40
1019 So. La Brea Ave.—R. E. Office..	7/ 1/41	6,744.42	337.22	10	9	674.44
R. E. Office Furniture						
1019 So. La Brea Ave.....	7/ 1/41	2,757.27	137.86	10	9	275.72
1020 Cadillac for Business	9/ 1/39	2,768.07	2,018.39	4	....	692.02

EXHIBIT F—(Continued)

INSTRUCTIONS

(References are to the Internal Revenue Code)

GAINS AND LOSSES FROM SALES OR EXCHANGES OF CAPITAL ASSETS AND OTHER PROPERTY.—Report details in schedule on other side.

“Capital assets” defined.—The term “capital assets” means property held by the taxpayer (whether or not connected with his trade or business), but not stock in trade or other property of a kind which would properly be included in his inventory if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property used in the trade or business of a character which is subject to the allowance for depreciation provided in section 23 (1), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer.

Section 165 (b) provides that if an employee receives the total distribution that he is entitled to under an employees’ trust plan that meets the requirements of section 165 (a) in one taxable year on account of his separation from service, the amount of such distribution to the extent exceeding the amounts contributed by the employee shall be considered a gain from the sale or exchange of a capital asset held for more than 6 months.

A capital gain dividend, as defined in section 362 (relating to tax on regulated investment companies), shall be treated by the shareholder as gains from the sale or exchange of capital assets held for more than 6 months.

For special treatment of gains and losses from involuntary conversion, and from sale or exchange of certain property used in the trade or business, see section 117 (j).

Description of property.—State following facts: (a) For real estate, location and description of land and improvements; (b) for bonds or other evidences of indebtedness, name of issuing corporation, particular issue, denomination and amount; and (c) for stocks, name of corporation, class of stock, number of shares, and capital changes affecting basis (including nontaxable distributions).

Basis.—In determining GAIN in case of property acquired before March 1, 1913, use the cost or the fair market value as of March 1, 1913, adjusted as provided in section 113 (b), which-

EXHIBIT F—(Continued)

ever is greater, but in determining LOSS use cost so adjusted. If the property was acquired after February 28, 1913, use cost, except as otherwise provided in section 113.

Losses on securities becoming worthless.—If (1) shares of stock become worthless during the year or (2) corporate securities with interest coupons or in registered form become worthless during the year, and are capital assets, the loss therefrom shall be considered as from the sale or exchange of capital assets as of the last day of such taxable year.

Nonbusiness debts.—If a debt, other than a debt evidenced by a corporate security with interest coupons or in registered form and other than a debt the loss from the worthlessness of which is incurred in the trade or business, becomes totally worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. Enter such loss in column 10 of schedule of short-term capital gains and losses on other side.

Classification of capital gains and losses.—The phrase “short-term” applies to gains and losses from the sale or exchange of capital assets held for 6 months or less; the phrase “long-term” to capital assets held for more than 6 months.

LIMITATION ON CAPITAL LOSSES.—Losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus the net income (computed without regard to capital gains and losses) or \$1,000, whichever is smaller. However, a net capital loss as defined in section 117 (a) (11) for a taxable year beginning in 1942 may be carried over to the taxable year 1943 and treated as a short-term capital loss. The amount of the net short-term capital loss for a taxable year beginning in 1941 may not be included in computing the net capital loss for a taxable year beginning in 1942 which can be carried forward to a taxable year beginning in 1943.

ALTERNATIVE TAX.—If the net long-term capital gain exceeds the net short-term capital loss, an alternative tax may be imposed in lieu of the normal tax and surtax imposed on net income. (See Computation of Alternative Tax, on other side.)

“Wash sales” losses.—Loss from sale or other disposition of stocks or securities cannot be deducted unless sustained in connection with the taxpayer’s trade or business, if, within 30 days before or after the date of sale or other disposition, the taxpayer has acquired (by purchase or by an exchange upon which the

EXHIBIT F—(Continued)

entire amount of gain or loss was recognized by law), or has entered into a contract or option to acquire, substantially identical stock or securities.

Losses in transactions between certain persons.—No deduction is allowable for losses from sales or exchanges of property directly or indirectly between (a) members of a family, (b) a corporation and an individual owning more than 50 per cent of its stock (liquidations excepted), (c) a grantor and fiduciary of any trust, or (d) a fiduciary and a beneficiary of the same trust.

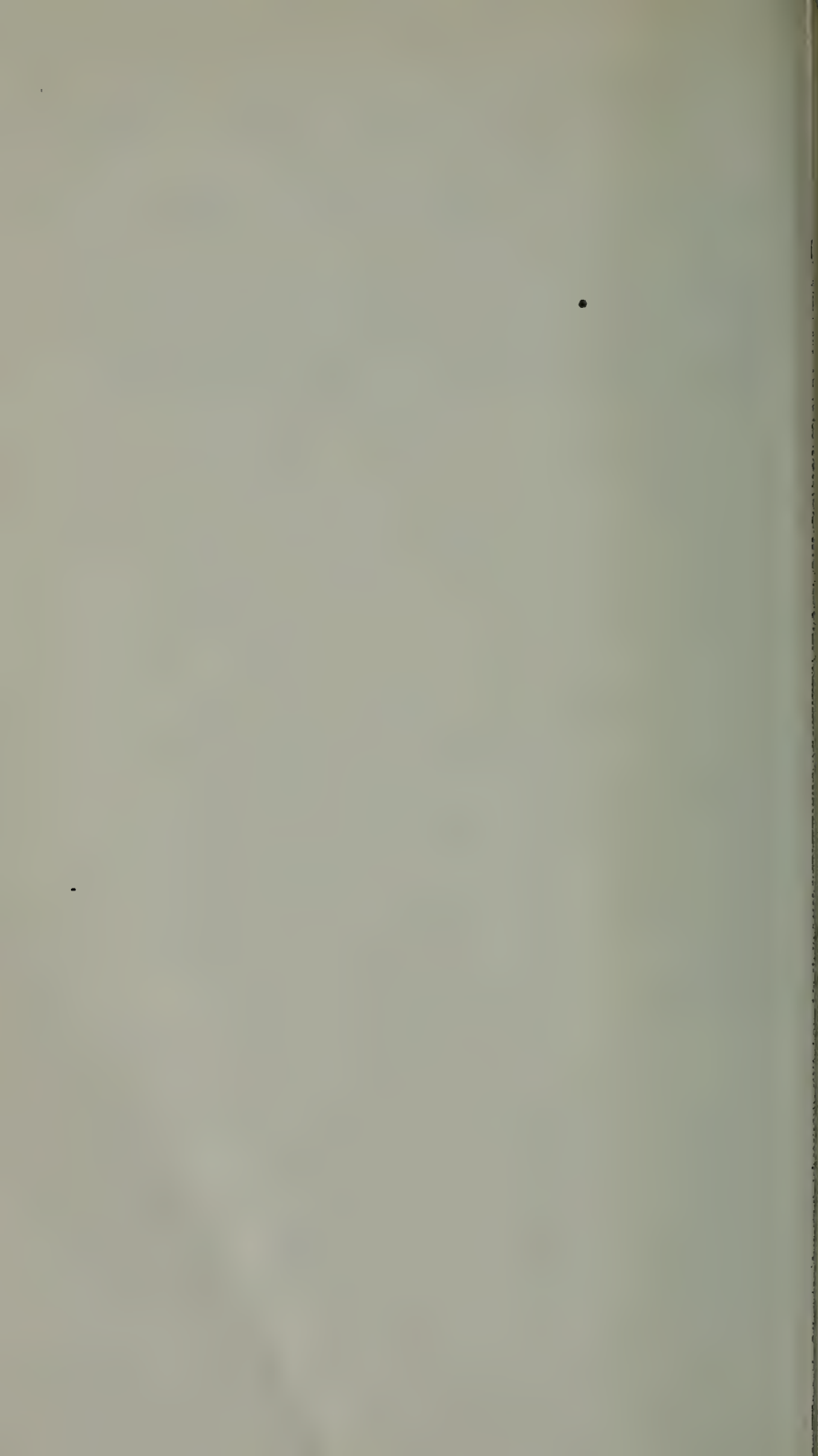


EXHIBIT F—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1943

Helen Field, 1019 S. La Brea Ave., Los Angeles, (35) Calif.

Schedule C 1

Line 1 Column 2

Rents Received

Address of Property	Amount
859 South Wooster	1,495.11
631 East Garfield (Glendale, Calif.).....	107.00
1830 North Cherokee (Commodore Apartments).....	21,178.75
Crestline Garage	291.25
1639 North Gower	470.00
1173 Highland Avenue.....	1,340.00
338 North La Brea.....	3,300.57
801 South Gramercy Drive.....	15,031.40
6016 Whitworth	3,880.00
1032 South Redondo Blvd.....	7,949.44
845 West Olympic (Baker Apartments).....	18,328.24
1019 South La Brea.....	300.00
4931 Venice Blvd.....	476.00
6282 Commodore Sloat Dr.....	2,004.86
2203 Beechwood	4,301.03
300 South Clark Drive.....	1,055.50
341 North Croft.....	562.50
1144 South Hi Point.....	448.00
900 North Kenmore.....	2,777.75
1248 La Jolla.....	799.25
2646 Vineyard	1,078.50
6439 Orange	600.57
Vacant Lot	24.00
Total Rents Received.....	<u>87,799.72</u>

EXHIBIT F—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1943

Helen Field, 1019 S. La Brea, Los Angeles, (35) Calif.

	Schedule C 1 Column 5 Line 1	Deductions Item 16
Salaries—Mgrs. and Ass't. Mgrs.....	11,504.74	
Office		3,860.74
Commissions Paid	36.75	33,689.97
Overriding Commissions		4,788.40
Pay Roll Taxes	176.63	1,084.74
Outside Rental Commissions Paid.....	3.75	
Heat, Light, Power.....	8,069.98	118.80
Stationery and Office Supplies.....	22.47	980.04
Janitor Supplies	322.05	75.90
Postage		290.64
Telephone	526.76	2,002.53
Repairs		624.26
Rents Paid		780.00
Taxes (L. A. County Prop.).....	9,613.18	388.93
Sales Tax		23.91
Licenses	71.00	25.00
Insurance	2,660.88	980.98
Interest Paid (See Schedule).....	11,121.18	437.06
Advertising—Newspapers	1.74	3,691.04
Signs		1.24
Auto Expense		569.85
Travel and Entertainment on Deals.....		210.14
Membership Dues, Subscriptions		145.35
Legal and Auditing.....	628.15	315.00
Business Donations		454.84
Realty Service		202.00
Laundry	1,776.38	
Service Charges	1,693.32	265.88
Sales Promotion		472.53
Gardening Supplies	156.09	13.94
Supplies for Apartment Management.....	106.67	
	<u>48,491.72</u>	<u>56,491.71</u>

EXHIBIT F—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1943

Helen Field, 1019 S. La Brea, Los Angeles, (35) Calif.

Schedule C 1

Line 2

Revenues and Expenses on Properties Owning $\frac{1}{2}$ Interest Only

	Berryman Coolidge	3270 Glendale Blvd.	801 South Gramercy	Totals
Rents Received	912.00	360.00	5,660.18	
Expenses:				
Wages			1,256.92	
Heat, Light and Water			589.02	
Stationery			1.37	
Janitor Supplies			20.80	
Postage			1.50	
Telephone			19.01	
Laundry			330.74	
Rent of Parking Lot			20.00	
Service Charges			90.44	
Interest	288.68	149.91	1,377.37	
Taxes	167.06	108.93		
Insurance	6.30	41.70		
Miscellaneous		8.92		
Repairs				
(Building)	15.66		79.63	
Equipment			222.14	
Total Expenses ..	477.70	309.46	4,008.94	
Net Gain	434.30	50.54	1,651.24	2,136.08
One-half Interest in Gain Reported Schedule C 1, Line 2.....				1,068.04

Note: Depreciation taken in Depreciation Schedule at one-half,
and charged against revenues all properties.

EXHIBIT F—(Continued)

INCOME TAX RETURN CALENDAR YEAR 1943

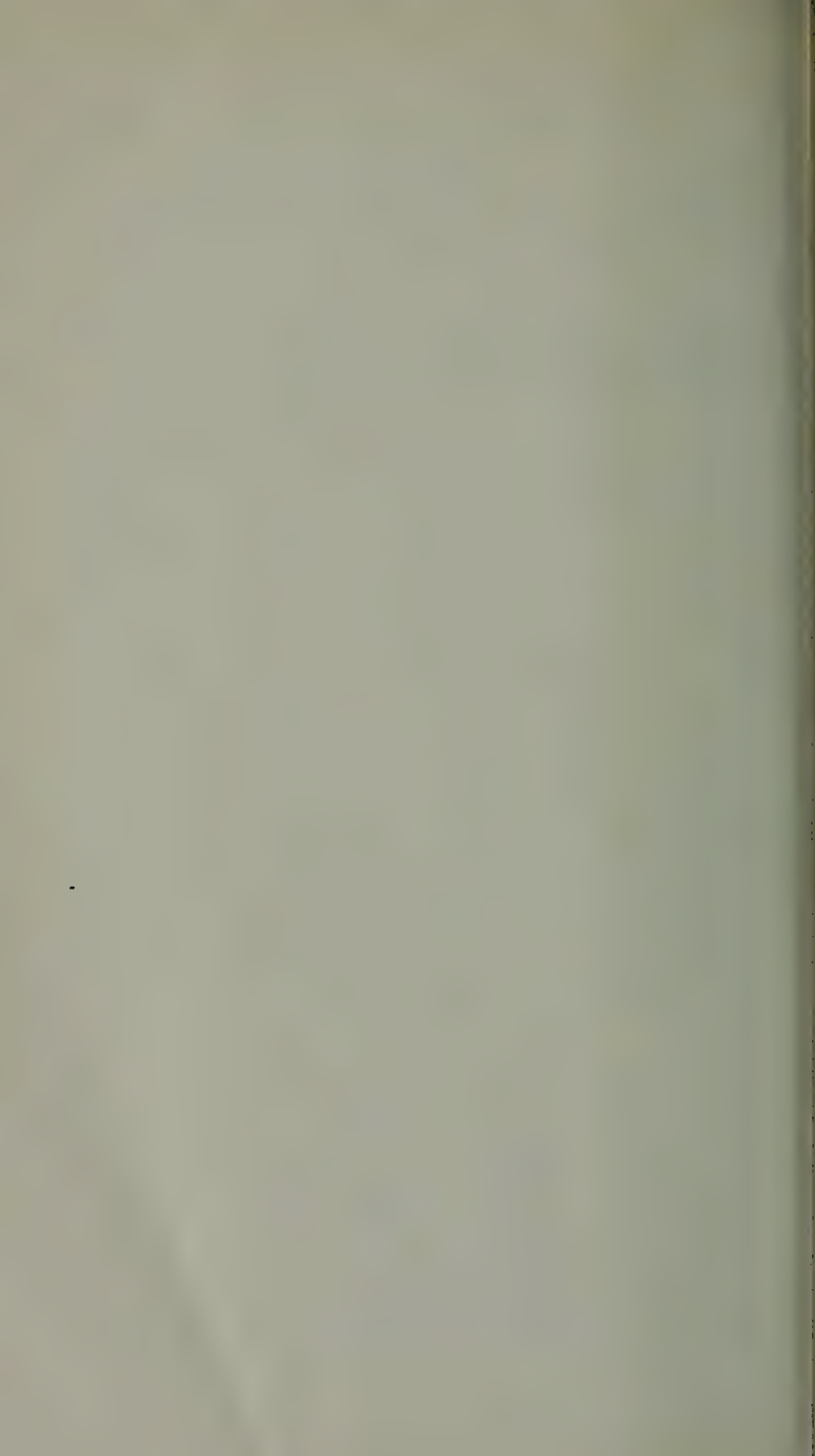
Helen Field, 1019 S. La Brea, Los Angeles, (35) Calif.

Schedule of Interest Paid

To Whom	Property	Mortgage Int.	Admin. Interest
Marvin E. Brown.....	1639 North Gower.....	121.00	
Syndicate Mortgage	739 South Normandie.....	1,542.66	
Western Service Corp.....	1173 S. Highland.....	418.79	
Prudential Ins. Co.....	338 North La Brea.....	450.57	
Pacific Mutual Life Ins.....	1032 South Redondo.....	613.02	
Belmont Co.	6016 Whitworth	634.99	
Belmont Co.	2203 Beechwood	753.67	
Ralph Sutro	859 S. Wooster.....	340.76	
Fred W. Heatherly.....	Lot #144, Tr. 7170.....	115.50	
Charles Baker	845 West Olympic.....	764.04	
M. E. & E. E. Ringemann.....	1830 North Cherokee.....	3,404.49	
Security 1st Nat'l. Bank.....	300 South Clark.....	144.83	
Security 1st Nat'l. Bank.....	300 South Clark.....		22.22
Provident Mutual	6282 Commodore Sloat Dr.....	250.49	
Provident Mutual	6282 Commodore Sloat Dr.....		30.43
Bank of America.....	341 North Croft.....	83.84	
Bank of America.....	338 North La Brea.....	70.18	

EXHIBIT F—(Continued)

To Whom	Property	Mortgage Int.	Admin. Interest
Bank of America.....	2646 Vineyard.....	290.58	
H. F. Whittle Inv. Co.....	1144 Hi Point.....	160.53	
John Hancock Mutual Life.....	900 S. Kenmore.....	533.35	
Gussie Booker	1248 La Jolla.....	215.58	
Clifford K. Steele.....	Palisades Lot	2.73	
Mortgage Guarantee	1248 S. La Jolla.....	141.46	
Mortgage Guarantee	744 N. Ogden.....	6.88	
Joe Endemiller	739 South Normandie.....	75.00	
Joe Endemiller	739 South Normandie.....		43.74
Mutual Life Ins. Co.....			77.99
Martha Sinclair			260.27
Collector of Internal Revenue.....			2.41
Total Interest Paid.....		11,121.18	437.06



TAX COURT OF THE UNITED STATES
WASHINGTON

Docket Nos. 13721 and 13722

EDDY D. FIELD and HELEN FIELD,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REVIEW OF DECISION OF
THE TAX COURT OF THE UNITED STATES

To the Honorable Judges of the United States
Circuit Court of Appeals of the Ninth Circuit:

Eddy D. Field and Helen Field, petitioners in
the above-entitled cases which were consolidated
for trial below, hereby petition this court to review
the decision of the Tax Court of the United States
heretofore entered in said proceedings on May 4,
1949. Petitioners respectfully represent:

I.

This petition is filed pursuant to Internal Revenue Code Sections 1141 and 1142, 26 U. S. C. A. Sections 1141 and 1142.

II.

Nature of Controversy

The present controversy relates to the proper determination of petitioners' Federal Income and Victory taxes for the calendar year 1943.

Respondent determined deficiencies to be due from petitioners for the calendar year 1943 as follows:

Eddy D. Field.....	\$7,913.65
Helen Field	8,083.13

The Tax Court of the United States, by its said decisions, sustained respondent in his determinations and petitioners hereby petition for a review of said decisions of the Tax Court of the United States.

III.

Venue

Petitioners are residents of Los Angeles, Los Angeles County, California, and filed their respective separate Federal Income Tax Returns for the calendar year 1943 with the Collector of Internal Revenue for the 6th District of California. Accordingly, petitioners are petitioning for a review of said decisions of the Tax Court of the United States by this Circuit Court of Appeals for the Ninth Circuit.

WHEREFORE, your petitioners pray that this Court review the said decisions of the Tax Court of the United States, reverse said Tax Court decisions, and direct entry of the decisions of said Tax Court in favor of petitioners and each of them determining that no deficiencies in Federal Income

or Victory taxes for the calendar year 1943 are due from the petitioners, or either of them.

DATED: JUNE 24, 1949.

Respectfully submitted,

/s/ GEORGE BOUCHARD,

Attorney for Petitioners.

State of California,
County of Los Angeles—ss.

George Bouchard, being first duly sworn, deposes and says:

That he is the attorney of record for petitioners, and is authorized by them to make this verification for and on their behalf since he is familiar with all of the matters involved; that he has read the foregoing Petition for Review of Decision of the Tax Court of the United States and knows the contents thereof; and that the same is true of his own knowledge, except as to the matters which are therein stated upon his information or belief, and as to those matters that he believes it to be true.

/s/ GEORGE BOUCHARD.

Subscribed and sworn to before me this 24th day of June, 1949.

[Seal] MARY E. McKNIGHT,
Notary Public in and for said County and State.

My Commission Expires August 5, 1952.

Affidavit of service by mail attached.

[Endorsed]: Filed T. C. U. S., July 1, 1949.

[Title of Tax Court and Cause.]

CERTIFICATE

I. Victor S. Mersch, Clerk of The Tax Court of the United States do hereby certify that the foregoing documents, 1 to 19, inclusive, constitute and are all of the original papers and proceedings on file in my office as called for by the "Designation of Contents of Record on Appeal" in the proceedings before The Tax Court of the United States entitled "Eddy D. Field, Petitioner v. Commissioner of Internal Revenue, Respondent" Docket No. 13721 and "Helen Field, Petitioner, v. Commissioner of Internal Revenue, Respondent" Docket No. 13722 and in which the petitioners in the Tax Court proceedings have initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceedings, as the same appear in the official docket book, in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 22nd day of July, 1949.

/s/ VICTOR S. MERSCH,

[Seal]

Clerk,

The Tax Court of the United
States.

[Endorsed]: No. 12308. United States Circuit Court of Appeals for the Ninth Circuit. Eddy D. Field and Helen Field, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States. Filed July 29, 1949.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

In the United States Circuit Court of Appeals
for the Ninth Circuit

Case No. 12308

EDDY D. FIELD and HELEN FIELD,
vs.

COMMISSIONER OF INTERNAL REVENUE.

STATEMENT OF POINTS AND
DESIGNATION OF CONTENTS OF RECORD
ON APPEAL

Statement of Points

Petitioners in the above-entitled consolidated proceedings intend to rely upon the following points on appeal:

(1) The Tax Court erred in holding that the two parcels of real property sold in 1942, and the eight parcels of real property sold in 1943, which they had held for more than six months for invest-

ment and rental income, were sales of property held by them primarily for sale to customers in the ordinary course of trade or business of buying and selling rental properties.

(2) The Tax Court erred in refusing to hold that petitioners held the two parcels of real estate sold in 1942, and the eight parcels of real estate sold in 1943, for investment and rental income and were, therefore, entitled to the benefits of Section 117(a) and/or 117(j) of the Internal Revenue Code.

(3) The Tax Court erred in holding that profit on the sale of the two real properties sold in 1942, and the eight parcels of real property sold in 1943, which had been held by them for more than six months, were taxable as ordinary income and not at capital gain rates.

(4) The Tax Court erred in approving deficiencies in income and Victory taxes against petitioners as determined by the respondent.

Designation of Contents of Record on Appeal

Petitioners in the above-entitled consolidated proceedings hereby designate the following portion of the records, proceedings and evidence before The Tax Court of the United States as material to the consideration of this appeal:

(1) Docket entries;

(2) Petition of petitioner, Eddy D. Field, Docket No. 13721;

(3) Petition of petitioner, Helen Field, Docket No. 13722;

- (4) Answer to Petition, Docket No. 13721;
- (5) Answer to Petition, Docket No. 13722;
- (6) Findings of Fact and Opinion of the Tax Court;
- (7) Decisions of the Tax Court;
- (8) Reporter's Transcript of proceedings before the Tax Court;
- (9) The following Exhibits introduced in evidence by respondent, "A," "B," "C," "D," "E" and "F"; and
- (10) Petition for Review of the Decisions of the Tax Court.

Also Clerk's Certificate.

Dated: August 1, 1949.

Respectfully submitted,

/s/ GEORGE BOUCHARD,

Attorney for Petitioners.

Affidavit of Service by Mail.

[Title of Court of Appeals and Cause.]

DESIGNATION OF CONTENTS OF
RECORD ON APPEAL

To Victor S. Mersch, Tax Court of the United States, Washington, D. C.

Petitioners in the above-entitled consolidated pro-

ceedings hereby designate the following portion of the record, proceedings and evidence before the Tax Court of the United States to be contained in the record on review by the Circuit Court of Appeals for the Ninth Circuit:

- (1) Docket Entries;
- (2) Petition of Petitioner Eddy D. Field, (Docket No. 13721);
- (3) Petition of Petitioner Helen Field, (Docket No. 13722);
- (4) Answer to Petition in Docket No. 13721;
- (5) Answer to Petition in Docket No. 13722;
- (6) Findings of Fact and Opinion of the Tax Court;
- (7) Decisions of the Tax Court;
- (8) Reporter's Transcript of the proceedings before the Tax Court;
- (9) The following Exhibits introduced in evidence by Respondent: Respondent's Exhibits "A," "B," "C," "D," "E" and "F."
- (10) The Petition for Review of the Decisions of the Tax Court and Notice of Filing Petition for Review, together with Proof of Service of said Petition and said Notice of Filing Petition;
- (11) This Designation of Contents of Record on Appeal and the Notice of Filing thereof, together with proof of service of said Designation and Notice.

Dated: June 24th, 1949.

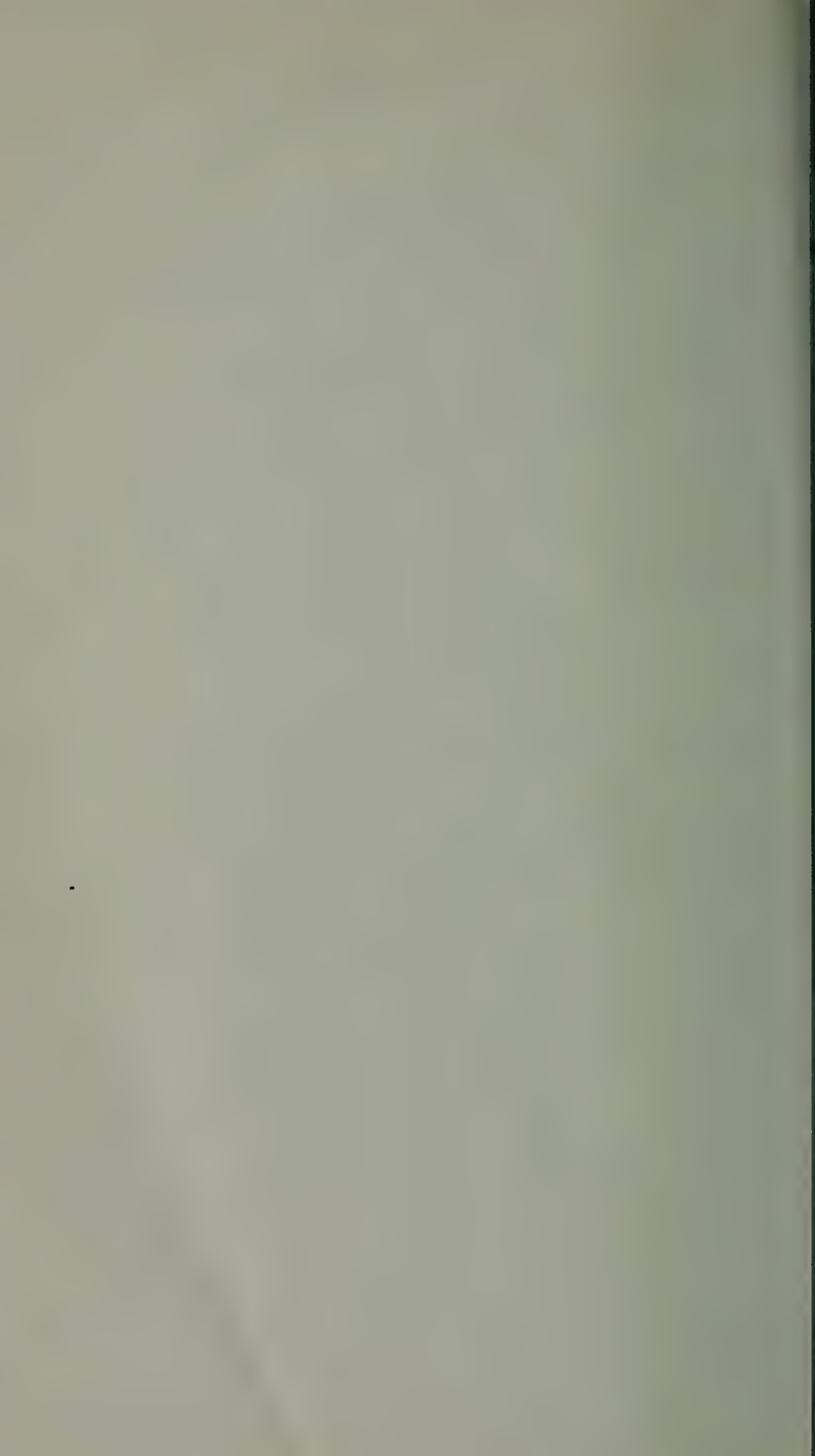
Respectfully submitted,

/s/ GEORGE BOUCHARD,

Attorney for Petitioners.

Affidavit of service by mail.

Received and filed T.C.U.S. July 1, 1949.



IN THE

EDDY D. FIELD and HELEN FIELD.

Petitioners,

2254

COMMISSIONER OF INTERNAL REVENUE.

Respondent.

BRIEF FOR PETITIONERS.

GEORGE BOUCHARD.

902 Bank of America Building, Los Angeles 14.

Attorney for Petitioners.

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I.

The sole question is whether the two parcels sold in 1942 and the eight parcels sold in 1943 of improved real estate were assets of a kind entitled to the benefit of Section 117 of the Internal Revenue Code.....	12
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STATUTES

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Sec. 1141	1, 2
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Nos. 13721 and 13722

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

EDDY D. FIELD and HELEN FIELD,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR PETITIONERS.

Jurisdiction.

This petition for review involves deficiencies in Federal income and Victory taxes for the year 1943 in the amount of \$7,913.65 as to petitioner Eddy D. Field, and \$8,083.13 as to petitioner Helen Field. The cases of the two petitioners involve identical issues and were consolidated for hearing before the Tax Court of the United States, hereinafter referred to as "Tax Court." The decisions of the Tax Court determining said deficiencies were entered May 4, 1949 [Tr. pp. 37-38]. This Petition for Review was filed July 1, 1949, pursuant to the provisions of Sections 1141 and 1142 of the Internal Code, 26 U. S. C. A., Sections 1141 and 1142.

Opinion Below.

The only previous opinion rendered in this cause is the memorandum opinion of the Tax Court [Tr. pp. 27-37]. This opinion was not reviewed by the Tax Court.

Questions Presented.

The sole question presented for decision is whether the profits realized by petitioners on the sales in 1942 of two pieces of improved real estate and the profits on the sales in 1943 of eight pieces of improved real estate, each held by them for more than six months for investment and rental income, are taxable as ordinary income or as capital gain.

Statutes and Regulations Involved.

Internal Revenue Code (26 U. S. C. A.):

“Sec. 117, Capital Gains and Losses.

(a) DEFINITIONS—as used in this Chapter.

(1) CAPITAL ASSETS. The term ‘capital assets’ means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1), * * * or real property used in the trade or business of the taxpayer.

(j) GAINS AND LOSSES FROM INVOLUNTARY CONVERSION AND FROM THE SALE OR EXCHANGE OF CERTAIN PROPERTY USED IN THE TRADE OR BUSINESS.

(1) Definition of property used in the trade or business. For the purposes of this subsection, the term 'property used in the trade or business' means property used in the trade or business of a character which is subject to the allowance for depreciation provided in section 23(1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k)(1) or (2) is applicable.

(2) General Rule.—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat of imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. * * *

REGULATIONS 111

Sec. 29.117-1. Meaning of terms.—The term 'capital assets' includes all classes of property not specifically excluded by section 117(a)(1). In determining whether property is a 'capital asset,' the period for which held is immaterial.

The exclusion from the term 'capital assets' of property used in the trade or business of a taxpayer of a character which is subject to the allowance for depreciation provided in section 23(1) and of real property used in the trade or business of a taxpayer is limited to such property used by the taxpayer in the trade or business at the time of the sale, exchange, or involuntary conversion. Gains and losses from the sale or exchange of such property are not subject to the percentage provisions of section 117(b) and losses from such transactions are not subject to the limitations on losses provided in section 117(d), except that under section 117(j) the gains and losses from the sale or exchange of such property, held for more than six months may be treated as gains and losses from the sale or exchange of capital assets, and may thus be subject to such limitations. See section 29.117-7. Property held for the production of income, but not used in a trade or business of the taxpayer, is not excluded from the term 'capital assets,' even though depreciation may have been allowed with respect to such property under sections 23(1) prior to its amendment by the Revenue Act of 1942. However, gain or loss upon the sale or exchange of land held by a taxpayer primarily for sale to customers in the ordinary course of his business, as in the case of a dealer in real estate, is not subject to the limitations of section 117(b), (c), and (d). The term 'ordinary net income' as used in these regu-

lations for the purposes of section 117 means net income exclusive of gains and losses from the sale or exchange of capital assets.

Sec. 29,117-7. Gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business.—Section 117(j) provides that the recognized gains and losses

(a) from the sale, exchange, or involuntary conversion of property used in the trade or business of the taxpayer at the time of the sale, exchange, or involuntary conversion, held for more than six months, which is

(1) of a character subject to the allowance for depreciation provided in section 23(1), or

(2) real property,

provided that such property is not of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or is not held by the taxpayer primarily for sale to customers in the ordinary course of trade or business. * * * shall be treated as gains and losses from the sale or exchange of capital assets held for more than six months if the aggregate of such gains exceeds the aggregate of such losses. If the aggregate of such gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets.”

Statement of Facts.

This proceeding was submitted to the Tax Court on the pleadings, oral testimony offered by the petitioners and exhibits introduced in evidence of the hearing.

The respondent introduced no evidence. The facts here involved may be summarized as follows:

1. Petitioner Eddy D. Field became a real estate salesman in Los Angeles in 1926. In 1927 he obtained a real estate broker's license and has been engaged in business as a real estate and insurance broker since that time [Tr. p. 45]. He started with no money. He married petitioner Helen Field in 1929. Mrs. Field has never been connected with his brokerage or insurance business [Tr. p. 45]. He started in this business with two associates in 1927; in 1934 petitioner bought out his associates and has since that date owned and operated the brokerage and insurance business on his own account [Tr. p. 46].

2. As a broker he represents buyers and sellers of real estate on a commission basis. He has never represented himself to be anything but a real estate and insurance broker [Tr. p. 47].

3. In 1934 petitioner and his wife organized a corporation known as Oxford Associates paying in \$2,000 for the stock of this company which they owned equally. This company was organized by them to purchase rental income properties as investments [Tr. pp. 47-48]. At that time petitioner had limited means and had to purchase small properties such as duplexes or 4-unit apartments which could be purchased for small down payments of from \$500 to \$1500 and the balance secured by mortgage. Oxford Associates bought any small property that it could afford which would return a rental income [Tr. p. 48].

4. Between 1934 and 1941 this corporation acquired nineteen pieces of such property [Tr. p. 49]. One or two properties were sold by the Corporation during those years but most were held as income producing units. On December 31, 1941, the corporation was dissolved and the properties were distributed to petitioners [Tr. p. 49]. They still own twelve of the nineteen properties distributed to them [Tr. p. 49].

5. In 1942 petitioner Eddy D. Field sold for others as a broker 148 pieces of property on which he received total commissions of \$52,000.00, and in 1943 he sold as a broker for others 155 pieces of property, receiving total commissions of \$71,000 [Respondent's Exhibits "C," "D," "E" and "F"]. In 1942 petitioners received as rental income from investment properties \$11,287 and in 1943 received rental income of \$16,958 [see same Exhibits].

6. The tax returns filed by petitioners for 1942 and 1943 [Respondent's Exhibits "C," "D," "E" and "F"] show date of acquisition of the properties involved in this proceeding, the cost and selling price and date of sales. It was stipulated that the facts shown on these returns with respect to such matters are correct [Tr. p. 44]. The properties which are shown on the returns as acquired by petitioner January 1, 1942, are the properties petitioner received from Oxford Associates on liquidation on that date. These properties were all acquired by petitioners' corporation between 1934 and 1941.

7. In January, 1942, petitioner Helen Field sold a residence at 1500 South Hauser. She acquired a half interest in the property in 1936 and purchased the remaining one-half interest in 1939. The profit on this sale was reported as long term capital gain by petitioners on com-

munity property basis. However, this was in error because the property is the separate property of petitioner Helen Field and not community property. Her mother and sister lived in this property and it was sold because the doctor had advised petitioner's mother she should move out of that locality.

8. Petitioners sold two properties in 1942, Longwood in March and Roxbury in July. Although Longwood had been acquired by Oxford Associates several years before, the profit on this sale was reported as short term gain because it was sold by petitioners within six months from the date it was distributed to them by the Corporation. The method of reporting the profit on this sale is not in controversy. Roxbury was a four-unit apartment acquired by Oxford Associates in 1938, with a down payment of \$1500. It produced a rental income. It was sold in 1942 to apply on the purchase price of an 8-unit apartment on Commodore Sloat Drive.

9. In 1943 petitioners sold eight pieces of improved real estate held by them for more than six months and purchased for investment and rental income and reported in their tax returns as long term capital gain the profit from their sale. These properties are known as LaJolla, Vineyard, Kenmore, Commodore Sloat Drive, Croft, High-Point, Beechwood, Clark. The petitioners sold the first four of these properties, namely LaJolla, Vineyard, Kenmore and Commodore Sloat, in order to purchase a 5-story, 75-unit apartment house known as Cherokee. The Cherokee property was purchased in July, 1943, for \$176,000 and required a down-payment of \$35,000 and an additional \$1500 for taxes and escrow expenses. This apartment building is still owned by petitioners although they

have received offers to sell it for \$450,000 [Tr. p. 53]. The original mortgage of \$140,000 had been reduced at the time of trial to approximately \$50,000 [Tr. p. 53]. Petitioners received monthly rentals of approximately \$1900 from the properties sold to finance the Cherokee purchase, whereas the rental of Cherokee Apartments is in excess of \$4600.00 monthly.

10. The LaJolla property was acquired by the Corporation in 1938. A bowling alley and liquor store had been built next to it and it became undesirable rental property.

11. The Vineyard property was acquired by the Corporation in 1936. The Kenmore property had been acquired in 1943. The Commodore Sloat was acquired in 1943. Croft was a duplex purchased by petitioners' corporation in 1935 and was sold in 1943 to purchase a 12-unit apartment on Orange. The Clark property was a 4-unit apartment acquired in 1946; in 1943 rents on it were frozen and petitioner sold it to buy two double bungalows on corner lot which they considered a better investment. High-Point was a house acquired in 1936 by petitioners' corporation which became vacant and rents were frozen at \$60 per month. It and the Beechwood property were sold in 1943 to acquire an interest in a six-story apartment building on Gramercy Street.

12. All of the properties acquired prior to 1942 by petitioners' corporation were small units bought for rental income and were purchased on small down payments, ranging from \$500 in the case of Croft, and \$1500 in the case of Roxbury.

13. Petitioner never used any of the money received by him from any of these sales in his brokerage and insurance business but rather took money from that business

to acquire his rental properties [Tr. p. 57]. The monies received from the sales of these properties were either invested in better rental property or used to pay off existing trust deeds on properties which petitioners owned, thereby increasing their equity [Tr. p. 57]. Petitioner testified that the properties sold in 1943 were never held primarily for sale but were held primarily as investments and for rental income [Tr. p. 58]. Petitioner Eddy Field had three real estate brokerage and insurance offices. Neither he nor any of his employees in the brokerage offices devoted any time to the management of his investment properties [Tr. p. 58].

14. Petitioners have still retained good properties purchased many years ago. For example, they still own a 2-store and 6-apartment unit at 338 North La Brea acquired in 1936, which is a good rental property [Tr. p. 58]. Also in 1938 they acquired a 4-story brick 45-unit apartment known as the Baker Apartment. Petitioners have had numerous offers to sell that property and have turned down as much as \$135,000 for it. They have refused to sell because it is the type of property they want to keep because it shows a good rental income, is a sound investment and is in a good location [Tr. p. 59].

15. Petitioners started to make real estate investments in small properties because that was all they could afford, but their objective was to acquire properties with large units. It was their idea as they could afford larger units they would dispose of the smaller ones with which to make the purchases. Their earnings were used to buy small places until they found and could afford large units such as the Cherokee, and when they found such opportunities they sold the small ones and bought the large ones. The large units they still own.

Specifications of Error.

(1) The Tax Court erred in holding that the two real properties sold by petitioners in 1942 and the eight real properties sold by them in 1943, which properties they had held for more than six months as investments and for rental income, were sales of properties held primarily for sale to customers in the ordinary course of their trade or business of buying and selling rental properties.

(2) The Tax Court erred in refusing to hold that petitioners held said ten parcels of real estate for investment and rental income and in failing to hold that petitioners were, therefore, entitled to the benefits of Section 117(a) and Section 117(j) of the Internal Revenue Code.

Summary of Argument.

(1) The sole point of disagreement is whether the profit on the sale of the ten parcels of real estate referred to are taxable at capital gain rates or as ordinary income. This depends upon the intent of petitioners in acquiring and selling said eight parcels.

(2) The finding that the properties in question were held primarily for sale to customers in the ordinary course of petitioner's trade or business finds no support in the evidence.

(3) The Tax Court's Conclusion of Law is inconsistent with its Findings of Fact because the Findings properly made compel the conclusion that the properties in question were capital assets.

(4) Should this Court be of the opinion that the Tax Court drew the ultimate inference which supports its decision, it nevertheless remains free to draw its ultimate inferences and conclusions which in its opinion the Findings of the Tax Court reasonably induce.

ARGUMENT.

I.

The Sole Question Is Whether the Two Parcels Sold in 1942 and the Eight Parcels Sold in 1943 of Improved Real Estate Were Assets of a Kind Entitled to the Benefit of Section 117 of the Internal Revenue Code.

There is no question raised as to the cost, selling price, holding period, or profit on the sales of these properties. It was stipulated that these facts are clearly shown on petitioners' Tax Returns, Exhibits "C," "D," "E" and "F." The properties involved are set forth in the Tax Court's Findings as the long term capital gain reported by petitioners in their 1942 and 1943 Tax Returns. In addition the Tax Court found that petitioners in 1943 sold seven pieces of real estate held for less than six months, the dates of acquisition and sale being set forth in the Findings.

The Tax Court's opinion begins by starting as follows:

"Specifically the question herein is whether the properties sold by petitioners in 1942 and 1943 were capital assets within the meaning of Section 117(a) (1) of the Internal Revenue Code, or were 'properties held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business'."

It is respectfully submitted that that is not the question in this case. The sole question is whether the two properties sold in 1942 and the eight sold in 1943 and held for more than six months, are entitled to the benefit of Section 117 of the Internal Revenue Code and the profit on their sale therefore taxable as "capital gains." We are not at all concerned with whether or not other properties

owned and sold by petitioners in 1943 were or were not entitled to the benefits of that section. We are concerned only with the properties which we reported for tax purposes as capital gains.

If the properties in question were held as investments and for rental income they are capital assets as defined in Section 117(a) of the Code; if it be held that petitioners were engaged in the business of holding rental properties for the production of rental income the profit on their sale is taxable as capital assets under Section 117(j) of the Code. The deficiency letter by which respondent determined the deficiencies in question states:

“The properties sold in 1942 and 1943 from which you reported net capital gains in the amount of \$3,607.19 and \$29,239.73 respectively, are not capital assets within the meaning of Section 117(a)(1) of the Internal Revenue Code, and the gains from the exchange or sale of the properties reported in 1942 and 1943 are fully taxable as business income. * * *”

It will be noted that the Commissioner's determination was based solely upon the ground that in his opinion these assets were not capital assets within the meaning of Section 117(a)(1). He made no determination as to whether or not the holding of these properties was of such a character as to be entitled to the remedial provision of Section 117(j) of the Code. It is the petitioner's contention that the properties in question were capital assets within the meaning of Section 117(a) but that in any event they were properties entitled to the benefits of Section 117(j). This depends upon the intent of petitioners in acquiring and holding said real estate.

II.

There Is No Evidence to Support the Tax Court's Finding That the Two Properties Sold in 1942 and the Eight Parcels Sold in 1943 Were Properties Held Primarily for Sale to Customers in the Ordinary Course of Their Trade or Business of Buying or Selling Real Estate for Profit.

Petitioner Eddy D. Field was the only witness who testified. His testimony shows that he has been a real estate broker in Los Angeles since 1927 earning his living by commissions earned on the sale of properties belonging to others; that when he started he had no financial resources; that he started business with two associates but finally in 1934 had acquired the interest in the brokerage business of the other two partners and since said date has operated his brokerage and insurance business himself; as a broker he listed for sale properties of other persons, advertised such properties, put signs upon them, and employed salesmen to sell them [Tr. p. 11]. In 1934 he and his wife organized a company known as Oxford Associates, in which they owned equally all of the stock. They organized this company for the purpose of purchasing rental income properties as investments. Their resources were limited and they started by purchasing small properties, duplexes of three or four units, requiring down payments of from \$500 to \$1,000. Petitioners paid into the corporation \$2,000 for their stock and the title to rental properties purchased were taken in the name of the corporation [Tr. pp. 12-13]. These properties were purchased with a small down payment and a mortgage given for the balance of the purchase price. The corporation acquired between its organization in 1934 and its dissolution December 31, 1941, nineteen properties. On this latter date

the corporation was dissolved and the properties distributed to petitioners in exchange for their stock. Of those nineteen properties so acquired by the corporation petitioners still own twelve.

In 1942, petitioner Helen Field sold a residence property on South Hauser which was her separate property and which she acquired in 1936, because her mother and sister were living there. On doctor's instruction, the mother was advised to seek a new location. Although petitioners reported this as community property, it is obvious that that was an error on their part. The property was the separate property of petitioner Helen Field and the profit is taxable to her. Petitioner Helen Field had never been in any business and the sale of that one property by her is clearly the sale of a capital asset.

Two other properties were sold by petitioners in 1942—Longwood and Roxbury. No evidence was offered with respect to reasons for the sale of Longwood as its profit was reported as short term gain because it was sold less than six months after January 1, 1942, the date petitioners acquired it on liquidation of Oxford Associates. The other property, Roxbury, was a 4-unit rental property acquired in 1938. It was sold in 1942 to purchase an 8-unit rental property.

The foregoing states absolutely all the evidence with respect to the sales in 1942, and yet the Tax Court held that the evidence showed that these properties were held primarily for sales to customers in the ordinary course of their trade or business of buying and selling real estate for profit. It is an almost incredible finding, but shows a lack of consideration given the undisputed facts by the Tax Court.

Petitioners sold eight rental properties in 1943. The only evidence in the record as to why these eight properties were purchased and sold is the uncontradicted evidence of petitioner Eddy Field. Six of the 8 properties had been acquired by the petitioner's corporation between 1935 and 1941. He testified they had all been purchased for investment and rental income and had been bought because they were purchased with small down payments and the balance on mortgages. He testified that it was his hope, as his financial resources permitted, to invest in larger rental units. Four of these properties were sold in 1943 to raise money with which to purchase a 5-story 75-unit apartment house building known as CHEROKEE, a rental property that produced \$4600 a month rent as opposed to \$1900 a month return by the rental properties he sold in order to buy it. Petitioners still own CHEROKEE in spite of opportunities to resell it at a tremendous profit and petitioners have decreased the mortgage from \$140,000 at the time of purchase, to approximately \$50,000 at the time of trial. This, we submit, is evidence of the fact that petitioner was trying to consolidate his equities in larger rental properties rather than holding smaller ones. Two other properties in question were sold to purchase an interest in a 6-story apartment building known as GRAMERCY. Of the two other properties sold, one was sold to buy a double bungalow considered a better investment, and the other was sold because it became vacant and rents were frozen. In each instance, the monies which petitioner realized from the sale of these rental

properties was used to purchase larger rental properties which produced a larger rental income.

Petitioner further testified that no one in his employ had anything to do with the sale of these properties, that they were not advertised for sale or listed by his brokerage office for sale and that they were separately set up in the books of account as his personal investments.

There is not one bit of evidence in the record to support the finding that Petitioner sold any of these properties to realize a profit. The evidence is he sold them to raise cash to buy larger rental properties which he considered more desirable investments.

The Tax Court's findings relate to intent. It is submitted that the Court had no alternative on the uncontradicted evidence but to find that petitioners' intent was to hold these properties for investment and rental income. See *Foran v. Commissioner*, 165 F. 2d 705. The question in that case was the intent of the taxpayer in respect to certain property, whether he intended to hold it for investment or for sale. The taxpayer's testimony as to his intent was the only evidence before the Court but the Tax Court held the properties were held for sale by the taxpayers. In reviewing the Tax Court's opinion the Court of Appeals distinguished *Greene v. Commissioner*, 141 F. 2d 645, and said:

"The distinction between that case and this is found in the majority opinion in these words:

" 'There was no direct proof of intent or purpose even in the testimony of Mr. Greene (taxpayer) and

the Tax Court was required to draw an inference as to this ultimate fact from the circumstantial evidence relative thereto.' Here there is direct and positive evidence from the witness who best knows that this property was for 17 months being held as an investment and not held for sale to customers. His testimony is consistent with every proven fact. He gives a credible reason why it was not for sale and why finally in 1941 he did sell it. We think the Court's refusal to follow the sworn testimony is contrary to law, and requires the setting aside of its fact-finding as it would that of a jury. We quote from *Penn. Railroad Co. v. Chamberlain*, 288 U. S. 333, page 340, 53 Supreme Court, 391, 394, 77 L. Ed. 819, 'And the desired inference is precluded for the further reason that respondent's right of recovery depends upon the existence of a particular fact which must be inferred from proven facts, and this is not permissible in the face of the positive and otherwise uncontradicted testimony of unimpeached witnesses consistent with the facts actually proved, from which testimony it affirmatively appears that the fact sought to be inferred did not exist. This conclusion results from a consideration of many decisions, of which the following are examples (citing cases): A rebuttable inference of fact * * * "must necessarily yield to credible evidence of the actual occurrence."' We recognize that intent may be proved by circumstances, and that a party's testimony as to his intent may be rebutted by proof of circumstances which are inconsistent therewith. We hold that no circum-

stances found by the Tax Court here is inconsistent with the reasonable and uncontradicted testimony of Foran.”

That is the identical situation we have here. Petitioner testified that he had held these properties as investments and for rental income; that four of them were sold in 1943 to raise money to purchase the 75-unit apartment which was producing almost two and one-half times as much monthly rental income. One was sold because it was vacant and rents frozen and the neighborhood had become undesirable. Two were sold to purchase more desirable income producing property—an interest in a 6-story apartment known as GRAMERCY.

Shortly after the decision in the case at Bar the Tax Court in a decision reviewed by the entire court, passed on what a security dealer must do to realize capital gain from a sale of securities of the same kind as those in which he deals. In the case of *Van Tuyl*, T. C. 119, the taxpayer's firm was an “over-the-counter” house specializing in defaulting railroad securities. During 1942, 1943, and 1944, the firm made many purchases and sales of two such issues. All transactions were entered on its books in regular trading accounts. In October 1942, believing that the bonds were good for a long pull, the firm purchased a \$35,000 block which it requested its bank to segregate and not deliver out of its account until further notice. The Bank acknowledged the advice, setting forth the number of the bonds so segregated. It placed the bonds in a

separate envelope and notified its security clerk to keep it separate from other bonds held as collateral for the firm's loans. On the firm's books the purchase was first entered in the regular trading account but at the end of the month it was transferred to a special account separate from the regular trading ledger. After closing out the regular account for October 1942, the firm discovered that due to an error, the account was short \$10,000 par value of the bonds in question. In November, to cover the shortage, it requested the Bank to release \$10,000 of the frozen bonds, which was done. Shortly thereafter the firm purchased additional blocks of the same bonds and replaced those which it had withdrawn from the frozen account. In 1944 the frozen bonds were sold at a profit.

The Commissioner treated the profit as ordinary income, arguing that the bonds were originally acquired as inventory items and that a mere intention to switch them to investments did not convert the profit into capital gain. The Court held that that argument did not apply to the facts here. These securities were acquired as investments and consistently held as such. It was held immaterial that some of them were immediately released and treated as inventory items, since the taxpayer showed that this was done merely to correct an error.

Shortly after this case the Tax Court decided the case of *Carl Marks & Co., Inc.*, 12 T. C. 161. In that case the taxpayer was a large dealer in foreign securities. On December 29, 1941, it transferred a block of these securities, which it had held in inventory, to an investment ac-

count. This block and other subsequent purchases were segregated both on the books and physically and were treated in a manner substantially different from the way the inventory securities were handled. The transferred securities were later sold at a profit which was determined after using as cost their value on the date they were shifted from inventory. The unanimous court held that the profits were properly treated as capital gain. Citing the *Van Tuyl* case the Court states:

“Certainly it cannot be argued that securities once acquired for resale to customers must forever retain their dealer status when in fact there has been a conversion of those securities from a dealer to an investment account.”

The crucial fact is the purpose for which the securities were held prior to their sale. The detailed steps taken to segregate the investment from the inventory securities established their investment character.

On July 6, 1949, the Tax Court decided the case of *Nelson A. Farry v. Commissioner*, 13 T. C. No. 3. In this case the taxpayer was simultaneously engaged in two types of real estate transactions. He was active in the sale of houses and lots in subdivisions he had developed and also held large numbers of low-grade buildings for the rental income they produced. In 1944 and 1945, as a result of the rent freeze and the increased demand for housing, he decided to sell his rental properties. He sold 19 in 1944 and 27 in 1945. Most of them had been held for over a year and some for as long as 11 years.

The Commissioner contended that the profits from the sale of the rental profits were taxable as ordinary income, contending that petitioner was holding the rental properties primarily for sale to customers in the ordinary course of his trade or business. The Tax Court held that the profits had been properly returned as capital gain, that they had been bought and held primarily for investments and not for sale to customers in the ordinary course of business. The fact that the taxpayer was also a dealer in real estate was immaterial. The Court, stating that if petitioner was holding the properties primarily for sale to customers they were not capital assets, said:

“However, it seems to us that petitioner has proved by overwhelming evidence that he purchased and held these properties primarily for investment purposes. The fact that in the taxable years he received satisfactory offers for some of them and sold them does not establish that he was holding them ‘primarily for sale to customers in the ordinary course of his trade or business.’ The evidence shows that he was holding them for investment purposes and not for sale as a dealer in real estate.”

If this Court should be of the opinion that the taxpayer was in the business of holding real estate for rental purposes, nevertheless, under Section 117(j) of the Internal Revenue Code, the profits from the sale of such properties are taxable as capital gains unless the properties are held primarily for sale to customers in the ordinary course of trade or business. (See *Nelson A. Farry, Inc.*, 13 T. C. 3; *Solomon Wright, Jr. v. Commissioner*, 9 T. C. 173, Acq. by Commissioner, 942 to C. B. 5; *Elgin Building Corporation*, T. C. M. (C. C. H. Decision T. C., Memorandum of Decisions 16831).)

III.

The Tax Court's Conclusion of Law Is Inconsistent With Its Findings of Fact Because the Findings Properly Made Compel the Conclusion That the Properties in Question Were Capital Assets.

Had the Tax Court made the Finding which, it is submitted, is the only Finding it could make on the uncontradicted evidence its Conclusion of Law under Section 117 of the Code had to be that the profit from the sale of these properties was taxable at capital gain rates as reported by petitioners.

In its Opinion, as distinguished from its Findings of Fact, the Tax Court gave its reasons justifying its Conclusion that the two properties sold in 1942 and the eight properties sold in 1943 were not taxable as capital assets.

Its Conclusion can only be reached by the application of a Rule of Law to the facts as found by drawing an inference from such facts to reach an ultimate Conclusion of Fact that said properties were not held for investment but were held primarily for sale. There is no fact found which compels the Finding that these properties were held primarily for sale to customers in the taxpayer's trade or business.

The factors relied upon by the Tax Court are the frequency and continuity of sales. This cannot apply to the sales in 1942 when there were only two sales by petitioners of rental properties each of which had been held for several years and one sale by Petitioner Helen Field of rental property owned by her. Research does not disclose any Rule of Law which if applied to these facts requires the Tax Court Conclusion, and in the face of uncontra-

dicted testimony to the contrary neither of these factors give rise to a justifiable inference that these properties were held primarily for sale. These factors are significant only in so far as they bear upon the factual issue of the intention of petitioners, namely, did they hold these properties for investment or for resale?

There are other factors in this case which bear on the question of intention. It is not disputed that all of the properties in question were purchased as investment and for rental income—in fact, the Tax Court finds substantially that this is true. They were all purchased with small down payments and the balance on mortgages or trust deeds, the amounts of which were from time to time reduced; these properties were carried on petitioner's books as investments; they were not advertised for sale and none of the petitioner's employees had anything to do with their management or sale. They were sold only when petitioner had an opportunity to buy larger rental properties and needed cash for that purpose, or when investment properties were available which were better than those they owned. There is no fact proved which is inconsistent with petitioner's uncontradicted testimony that these properties were held for investment and rental income and not primarily for sale; every fact proved is consistent with that testimony and there is no valid legal reason why the Tax Court should not have accepted it. Petitioner contends that as a matter of law, it was error to refuse to accept that testimony and make a Finding based upon it. The Tax Court, on the undisputed evidence, should have found that the properties in question were held as investments and for rental income, and that therefore the profit on their sale was taxable as capital gain.

IV.

Should This Court Be of the Opinion That the Tax Court Drew the Ultimate Inference Which Supports Its Decision, It Nevertheless Remains Free to Draw Its Own Ultimate Inference.

The scope of review of decisions of the Tax Court by the Courts of Appeal is no longer subject to the restrictions imposed by *Dobson v. Commissioner*, 320 U. S. 489. See Section 1141(a), Internal Revenue Code, which became effective September 1, 1948. The Courts of Appeal now have jurisdiction to review decisions of the Tax Court, "in the same manner and to the same extent as decisions of the District Court actions tried without a jury."

While it has long been established practice of the Circuit Courts not to set aside a Finding of Fact of the District Court unless clearly wrong or unsupported by substantial evidence this rule is restricted to situations where the subjects of review are evidentiary or primary facts which the Court has found upon hearing witnesses who appeared before it so that it was in a better position than the Reviewing Court to judge their credibility as opposed to situations in which the question is one of drawing inferences from the facts found by the Trial Court. In the latter situation the Reviewing Court is in as good a position to draw its own inferences or conclusions from the evidentiary facts as found by the Trial Court as is the Trial Court itself, since there is no question of credibility of witnesses involved. See *Kuhn v. Princess Lida of Thurn & Taxis*, 119 F. 2d 704, a leading case stating this principle. In this case the plaintiff sued for reasonable attorney's fees for professional services rendered to defendant in connection with a tax controversy before the

Tax Court. The District Court found that \$8,500.00 was a reasonable attorney's fee considering all the facts of the case, including difficulty of legal problems involved, amount of time spent in litigation and other matters. The Court reversed and remanded with direction to enter judgment for \$2,500.00 in favor of the plaintiff. The Court said that the Conclusion as to the reasonable value of the service was an ultimate fact and so subject to a complete review on appeal. The Court said:

“The appellee reminds us that we are not at liberty to disturb findings of fact made by the trial court unless they are unsupported by evidence or are otherwise clearly erroneous. Rule 52(a), 28 U. S. C. A. following section 723c. The reason for the rule rests in large part upon the fact that the trial judge who hears the witnesses testify and observes their demeanor upon the stand is better qualified to appraise the credibility of their testimony and to resolve the conflicts therein. So long, therefore, as a finding of fact is supported by evidence, and is not clearly erroneous, it is to be accepted on appeal as verity.

The rule does not operate, however, to entrench with like finality the inferences or conclusions drawn by the trial court from its fact findings. And so, while accepting the facts competently found by the trial court as correct, an appellate court remains free to draw the ultimate inferences and conclusions which, in its opinion, the findings reasonable induce. Such was the law prior to the promulgation of the Rules of Civil Procedure. *Brown v. United States*, 3 Cir., 95 F. 2d 487, 490; *Dunn v. Trefry*, 1 Cir., 260 F. 147, 148. The new Rules have worked no change in this regard, or with respect to the ultimate conclusions in jury-waived cases in particular. Cf. *Aetna Life Insurance Co. v. Kepler*, 8 Cir., 116 F.

2d 1, 5. See also 3 Moore, Federal Practice, p. 3115, *et seq.* and notes of the Advisory Committee on Rule 52(a). The sufficiency of the evidence to sustain a trial court's conclusion or finding of an ultimate fact remains appropriate matter for an appellate court's consideration. *State Farm Mutual Automobile Insurance Co. v. Bonacci et al.*, 8 Cir., 111 F. 2d 412, 415. Where the evidentiary facts are not in conflict or dispute, the conclusions to be drawn therefrom are for the appellate court upon review of the trial court's action. *Cf. United States v. South Georgia Railway Co.*, 5 Cir., 107 F. 2d 3, and *United States v. Mitchell*, 8 Cir., 104 F. 2d 343, 346. An incorrect conclusion by a trial court qualifies as a 'clearly erroneous' finding, for the correction whereof on appeal Rule 52(a) specifically provides.

In the instant case, the trial court's conclusion as to what constituted reasonable compensation for the plaintiff's services rested upon no direct testimony of witnesses. Not only were the respective witnesses far apart in their estimates as to the value of the plaintiff's services but none of them approximated the amount arrived at by the trial judge. The plaintiff himself testified to \$25,000 (the amount for which he sought recovery) as the value of his time and effort. And, of the two experts whom he produced, one testified to \$25,000 and the other to \$30,000. On the other hand, one of the defendant's experts fixed the value of the services at \$1,500 while the other gave \$2,000 as his estimate, the latter sum also covering some services contemporaneously performed by the plaintiff for defendant's sons with respect to assessments for tax on income received by them from the same source as the defendant's."

This Court recently reversed the Tax Court by drawing its own ultimate inference from the undisputed facts,

which inference was contrary to the inference drawn by the Tax Court. In *Wilshire and Western Sandwiches, Inc. v. Commissioner*, 175 F. 2d 718, the facts in that case were that the taxpayer was incorporated for the purpose of engaging in the restaurant business and the original intention of its four incorporators, which later became its stockholders, was to finance the construction of the restaurant out of advances made by them in the amount of \$30,000, half of which was to be capital stock contribution and half a loan. The Tax Court found the parties intended to make advances for stock and loans on an equal basis, yet it found from inferences drawn by it from other facts that the original intent was nullified.

In holding that the advances were converted into investments so that interest was not deductible, the Tax Court emphasized that the advances were made at the same time as the capital investments, in the same proportions and for the same purpose—to provide working capital; that the incorporators varied the ratio between loans and investments from the original plan; though the first advances were made in May, 1941, the notes given in the corporation were not recorded until April or May, 1942, and they were not secured; also interest was not accrued on its books until 1943 and was not paid until December 1, 1943. The Tax Court emphasized that the initial book entries did not treat the advances as loans; that the payments of interest and principal were made from the profits of petitioner as the incorporators expected. This Court reversed that decision, finding that the chief factor was the stockholders' intent at the time of entering the transaction that it be a loan. This Court said:

“Respondent asserts that the transactions under consideration here have few of the characteristics of

the people dealing at arm's length. Whatever view may be taken as to the number of those characteristics, the controlling fact remains that those which appeared are the essentials of a bona fide transaction. In reaching this conclusion we think we are dealing with substance and reality and not mere form, a requirement in the field of taxation."

As applied to the case at bar the ultimate inference is, the inference as to whether the properties in question sold in 1942 and 1943 were held by petitioners for investment and rental income, or whether they were held primarily for sale to customers in the ordinary course of their trade or business. This Court is as competent as the Tax Court to draw this inference from the relevant facts. This Court, sitting as a court of review, is free to determine the intention of the parties from the primary facts competently found by the Tax Court without regard to whether or not there is support in the record for the inference drawn by the Tax Court. However, it is submitted that only one reasonable inference can be drawn from the undisputed evidence, and that is, that the properties sold by petitioners in 1942 and 1943 were held by them for investment and rental income and not primarily for sale to customers, and that they are, therefore, entitled to capital gain benefits.

It was the intention of Congress in enacting Amendment to the Internal Revenue Code, Section 1141(a)m that reviewing courts should have the power to draw their own conclusions as to ultimate facts. The Senate Committee on the Judiciary stated the language approved had the effect of repealing the rule of *Dobson v. Commissioner*, *supra*,

" . . . to the effect that decisions of the Tax Court on questions of fact, including questions of account-

ing and ultimate conclusions of fact, are not reviewable if supported by any evidence in the record.”

Senate Committee on Judiciary, 80th Congress,
Second Session, Report No. 1559, p. 131.

Congress felt that courts of review should be free to reverse decisions of the Tax Court on questions of ultimate fact without reference to whether or not the conclusions of the Tax Court had support in the record. This insures that the most reasonable of conflicting inferences will be chosen and justice done.

Conclusion.

Only one reasonable conclusion can be reached from the facts in this case and that is, that the real properties sold by petitioners in 1942 and 1943 were held by them as investments and for rental income and that they were not held primarily for sale to customers in the ordinary course of taxpayers' trade or business. The profits on their sale, therefore, is taxable at capital gain rates and not as ordinary income.

The decisions of the Tax Courts should, therefore, be reversed and judgment entered in favor of the petitioners, holding the profits on the sales of the properties in question were correctly reported as profits from the sale of Capital Assets, and not ordinary income.

Respectfully submitted,

GEORGE BOUCHARD,

Attorney for Petitioners.

No. 12308

**In the United States Court of Appeals
for the Ninth Circuit**

EDDY D. FIELD AND HELEN FIELD, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

**ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX COURT
OF THE UNITED STATES**

BRIEF FOR THE RESPONDENT

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Assistant Attorney General.

ELLIS N. SLACK,

A. F. PRESCOTT,

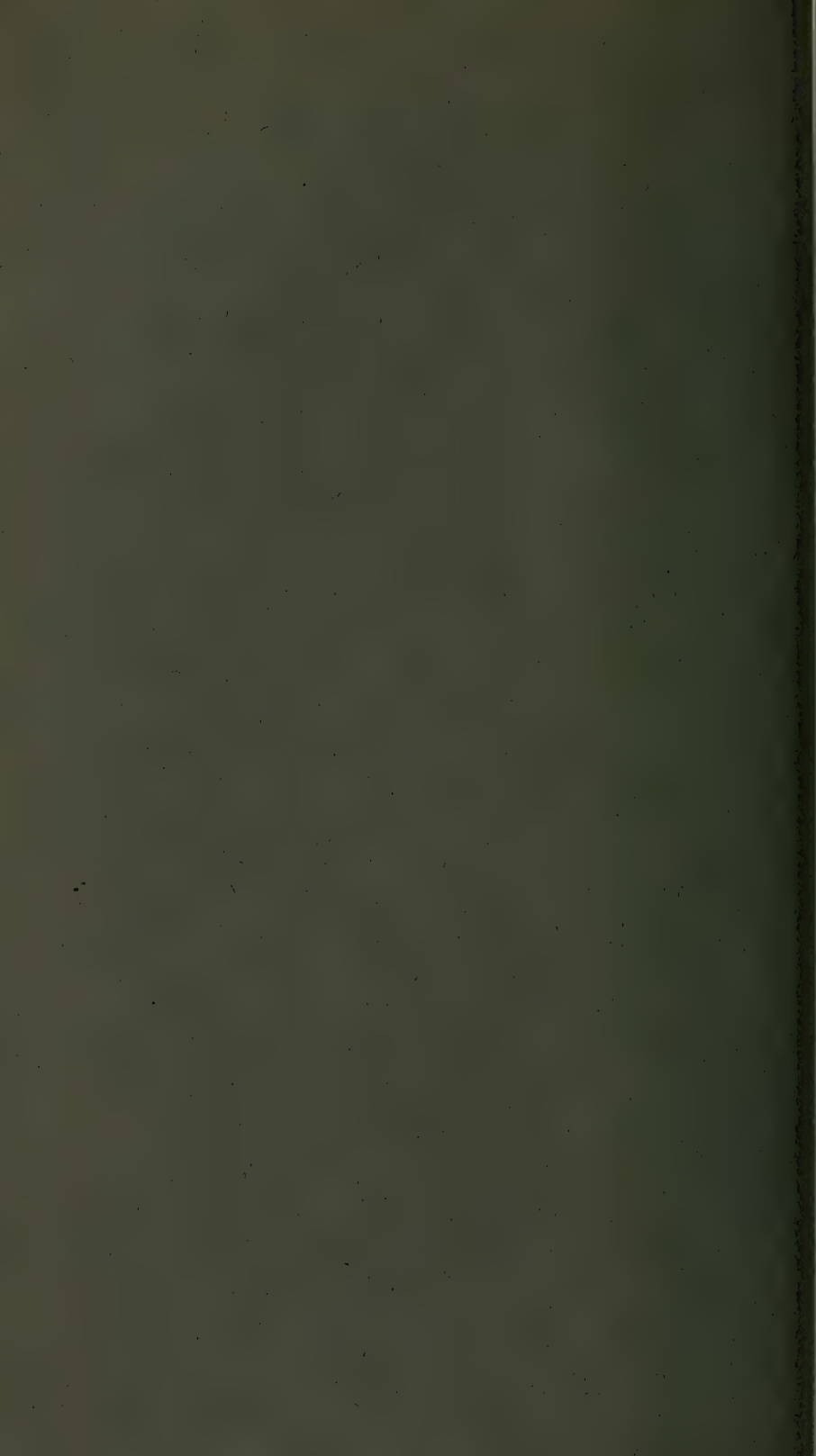
EDWARD J. P. ZIMMERMAN,

Special Assistants to the Attorney General.

FILED

DEC 11 1924

PAUL P. QUINN



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BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum opinion of the Tax Court (R. 27-37) is not reported.

JURISDICTION

This petition for review (R. 147-149) involves federal income and victory taxes for the year 1943. The year 1942 is also involved because of Section 6 (the forgiveness features) of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126.

On February 25, 1947, the Commissioner of Internal Revenue mailed to the taxpayers, husband and wife, notices of deficiencies in the amounts of \$7,913.65 and \$8,083.13, respectively. (R. 10-14, 20-25.) Within ninety days thereafter and on April 29, 1947, the taxpayers filed petitions in the Tax Court for redeter-

mination of tax deficiencies, under the provisions of Section 272 of the Internal Revenue Code. (R. 7-14, 16-25.) The proceedings were consolidated for hearing before the Tax Court. (R. 2, 5, 27.) The decisions of the Tax Court determining the deficiencies were entered May 4, 1949. (R. 37-38.) This case is brought to this Court by a petition for review filed July 1, 1949 (R. 147-149), pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether the court erred in affirming the Commissioner's determination that profits realized by taxpayers during 1943 from sales of real estate represented ordinary business income, not capital gains under Section 117 of the Internal Revenue Code.

STATUTES AND REGULATIONS INVOLVED

These may be found in the Appendix, *infra*.

STATEMENT

The facts as found by the Tax Court (R. 28-32, 34-35) may be summarized as follows:

Taxpayers are husband and wife, residents of California, and filed separate income tax returns on a community basis for the taxable years involved. (R. 28.) Since the income in question was community income, the issue is the same for each taxpayer.¹

In 1927 the taxpayer husband obtained a real estate brokerage license and since that time has been en-

¹ The proceedings were consolidated for hearing below (R. 27), and a single petition for review was filed (R. 147).

gaged in business as a real estate and insurance broker in Los Angeles, California. During the taxable year 1943 he maintained three offices in that city and employed a number of real estate salesmen. During the years 1942 and 1943, his organization handled the sale of over 300 properties, for which he received total commissions of \$52,039.07 in 1942 and \$72,177.83 in 1943. (R. 28-29.)

In 1934 taxpayers organized a real estate corporation known as Oxford Associates, paying in \$2,000 in exchange for all of the stock which they thereafter held equally. Between 1934 and 1941, this corporation acquired various real estate properties in Los Angeles. Some of these it sold during this period, but most were held as income producing properties. At the end of 1941, the corporation was dissolved and its 19 properties were distributed in liquidation to taxpayers as its sole stockholders. Of these, eleven were improved income producing properties and eight were unimproved lots. In 1942, two of the improved properties were sold at a profit, and the proceeds of one of these sales were applied on the purchase price of another property. In that year the taxpayer wife sold at a profit another piece of property which she had acquired in 1939. (R. 29-30.)

By the end of 1943 taxpayers had left four of the income producing properties and the eight unimproved lots received on liquidation of Oxford Associates, the other properties having been sold. (R. 31.)

In their 1943 income tax returns, taxpayers reported as long-term capital gains the profits from the sales of the following properties (R. 30):

	Date Acquired ¹	Date Sold	Sale Price	Cost Price
1248 S. LaJolla.....	1/ 1/42	5/12/43	\$17,109.66	\$13,500.00
2646 Vineyard.....	1/ 1/42	6/16/43	13,250.00	10,500.00
900 Kenmore.....	12/26/41	6/ 9/43	44,000.00	32,022.91
6282 Commodore Sloat Dr.....	8/29/42	6/11/43	23,900.00	19,715.52
341 N. Croft.....	1/ 1/42	6/ 5/43	9,524.37	7,026.93
1144 S. Hi-Point.....	1/ 1/42	9/16/43	7,499.96	5,500.00
2203 Beechwood.....	3/24/43	10/13/43	57,500.00	44,500.00
300 S. Clark.....	1/ 1/42	8/ 5/43	14,000.00	9,520.00

¹ The properties which are shown as being acquired by taxpayers on January 1, 1942, are the properties they received on liquidation of Oxford Associates. These properties were all acquired by that corporation between 1934 and 1941. (R. 29, 31.)

In addition taxpayers reported as short-term capital gains, the profits from sales of the following properties (R. 32):

Address	Date Acquired	Date Sold	Sale Price	Cost Price
626 W. 17th St.....	6/23/43	6/23/43	\$17,500.00	\$12,750.00
6439 S. Orange.....	6/ 1/43	7/ 8/43	27,300.00	24,825.51
424 Kings Rd.....	2/24/43	3/24/43	6,450.00	6,006.00
526 Harper.....	1/ 9/43	2/26/43	5,900.00	5,049.53
849 S. Holt.....	6/ 6/43	7/ 6/43	7,000.00	6,357.51
1208 Pointview.....	2/20/43	3/23/43	6,900.00	6,751.96
2031 Manning.....	10/ 1/43	11/ 1/43	5,600.00	4,533.10

From the sale of five of the above properties (LaJolla, Vineyard, Kenmore, Commodore Sloat, W. 17th) taxpayers realized about \$44,000, which was applied as part of the price of another property (Cherokee) purchased for \$176,000 in July, 1943, and still held by taxpayers. The monthly rentals from the five properties sold were about \$1,900, while those from the larger property purchased was about \$4,600. The proceeds of another property (N. Croft), sold in June of 1943, were used to purchase still another property (S. Orange) which taxpayers in turn resold the following month. The proceeds of two other properties sold in 1943 (Hi-Point and Beechwood) were

used to buy an interest in still another property (S. Gramercy). The proceeds of still another property sold in 1943 (S. Clark) were used to purchase another which produced about the same income. (R. 31-32.)

The net rental income derived by taxpayers during the calendar year 1943 was \$16,958.08. (R. 32.) The profits realized from the sale of real estate in that year amounted to \$50,894.64. (R. 35.)

In 1943 taxpayers handled no less than 25 separate transactions involving ten purchases and fifteen sales of rental properties. Seven of the ten properties purchased in 1943 were resold within two months of their purchase, all at a profit. From 1942 through 1944, taxpayers sold a total of 27 different real properties, all at a profit. In 1942 three properties were sold for \$30,700, from which profits of \$5,169.24 were realized. In 1943, fifteen properties were sold for \$263,443.99, from which profits of \$50,894.64 were realized. In 1944, nine properties were sold. The transactions were of sufficient frequency, continuity and substantiality to constitute the carrying on of a business. (R. 34-35.)

The properties sold by taxpayers during the taxable years were properties held primarily for sale to customers in the regular course of the business of buying and selling real estate for profit. (R. 32.)

In their income tax returns for 1943, taxpayers treated the \$50,894.64 profits realized in that year from sales of real estate as capital gains, and reported only \$29,815.84 as net capital gains. The Commissioner determined that the gains were taxable in full as

ordinary business income. (R. 13, 23, 32.) The Tax Court sustained the Commissioner's determination. (R. 33-37.)

SUMMARY OF ARGUMENT

The Tax Court properly sustained the Commissioner's determination that the profits by taxpayer's² sales of real estate during 1943 represented ordinary business income, not capital gain. It is settled that whether property is held primarily for sale in the ordinary course of business (and hence excluded from the definition of capital gains contained in Section 117 of the Internal Revenue Code) depends upon the frequency and continuity of the sales, and that this presents a question of ultimate fact. The Tax Court found that the properties in question were so held, and that finding is amply supported by the record. The number of properties bought and sold, the consideration received, and the profits realized show that the sales were not casual but frequent and continuous, and that taxpayers were engaged in the business of buying and selling real estate, for their own account. Further support for the Tax Court's conclusion is found in taxpayer's admission in his return for the taxable year that his business was that of "Realtor & Prop. Mgmt.", and by his own testimony to the effect that he bought in order to resell and use the sales proceeds to purchase still bigger properties. There is no basis for disturbing the Tax Court's decision.

² Since the taxpayers' business operations were conducted by the husband, he will be referred to throughout the argument as the taxpayer, although the wife's liability is also in issue because the taxpayers reported on a community basis.

ARGUMENT

The profits in question represented ordinary income, not capital gains

The sole question presented is whether the profits derived from taxpayer's sales of realty during the taxable year 1943³ represented ordinary business income as determined by the Commissioner and held by the Tax Court, or capital gains, as contended by taxpayer. If ordinary income, they are taxable in full under Section 111 of the Internal Revenue Code (Appendix, *infra*). If capital gains, they are taxable only to the limited extent provided in Section 117 (b) of the Internal Revenue Code (Appendix, *infra*). The answer turns on whether the properties sold constituted "capital assets" as defined in Section 117 (a) of the Internal Revenue Code (Appendix, *infra*). That section defines capital assets as property held by the taxpayer, whether or not connected with his trade or business, but excludes *inter alia* "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." In conjunction with the statutory provisions, Section 29.117-1 of Treasury Regulations 111 (Appendix, *infra*), provides that gain or loss upon the sale or exchange of land held by a taxpayer primarily for sale to customers in the ordinary course of his business "as in the case of a dealer in real estate" is not subject to the limitations of Section 117 (b), but is ordinary income.

³ While the year is 1943, tax liability for the year 1942 is also involved because of Section 6 (the forgiveness feature) of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126.

The test for determining whether property was "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business" is now well established by numerous decisions of this Court and other Courts of Appeals. The primary test is the "frequency or continuity" of the sales. *Ehrman v. Commissioner*, 120 F. 2d 607, 610 (C. A. 9th), certiorari denied, 314 U. S. 668; *Richards v. Commissioner*, 81 F. 2d 369 (C. A. 9th); *Commissioner v. Boeing*, 106 F. 2d 305 (C. A. 9th), certiorari denied, 308 U. S. 619; *Welch v. Solomon*, 99 F. 2d 41 (C. A. 9th); *Snell v. Commissioner*, 97 F. 2d 891 (C. A. 5th); *Brown v. Commissioner*, 143 F. 2d 468 (C. A. 5th); *Greene v. Commissioner*, 141 F. 2d 645 (C. A. 5th), certiorari denied, 323 U. S. 717; *McFaddin v. Commissioner*, 148 F. 2d 570 (C. A. 5th); *Oliver v. Commissioner*, 138 F. 2d 910 (C. A. 4th); *Gruver v. Commissioner*, 142 F. 2d 363 (C. A. 4th); *Dunitz v. Commissioner*, 167 F. 2d 223 (C. A. 6th). Whether the sales are of sufficient frequency or continuity to constitute the carrying on of the "business" of selling presents a problem of ultimate fact. *Richards v. Commissioner, supra*; *Greene v. Commissioner, supra*; *White v. Commissioner*, 172 F. 2d 629 (C. A. 5th). The Commissioner's determination is presumptively correct, and the taxpayer thus has the burden of proving it wrong. *Commissioner v. Boeing, supra*; *Miller v. Commissioner*, 102 F. 2d 476, 480-481 (C. A. 9th). Accordingly, the Tax Court's finding should not be disturbed unless clearly erroneous. *Richards v. Commissioner, supra*; *Ehrman v. Commissioner, supra*; *Greene v. Commissioner, supra*; *Gruver v. Commis-*

sioner, *supra*; Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948, c. 646, 62 Stat. 869.

The Commissioner determined (R. 13-14, 24, 32) that the profits realized from taxpayer's sales of realty in 1943, amounting to \$50,894.64, were taxable in full as "business income" and not as a net capital gain of \$29,239.73 as reported by the taxpayer. The Tax Court found that the real estate was held primarily for sale to customers in the ordinary course of taxpayer's business of buying and selling real estate for profit (R. 32), and sustained the Commissioner's determination. Applying the established "frequency or continuity" test, it concluded that taxpayer was engaged in the business of buying and selling real estate for his own account, in addition to being a real estate broker and investor in rental properties. (R. 33-34.) We submit that its conclusion is not only warranted but demanded by the record.

Taxpayer made ten purchases and fifteen sales in 1943, an average of one transaction every two weeks. (R. 34, 118, 140.) Each sale was made at a profit; the total consideration received amounted to \$263,433.99 and the total profits amounted to \$50,894.64. (R. 35, 68-69, 118, 140.) All of the seven properties sold in 1943, with respect to which taxpayer claimed short-term capital gains, had been purchased less than two months before their sale; one of them (626 W. 17th St.) was resold on the very day on which it was originally purchased. (R. 32, 68, 118.) As for the other eight properties sold in 1943, with respect to which taxpayer claimed long-term capital gains, one

(Beechwood) had been purchased six months before; another (Commodore Sloat) less than a year before; another (Kenmore) at the end of 1941; and the others were acquired at the beginning of 1942 upon liquidation of Oxford Associates. (R. 30, 69, 118.) In addition, taxpayer sold another nine properties in 1944, at a total profit of \$33,163.24. (R. 35, 74.)⁴

As the Tax Court noted (R. 34-35):

The record discloses that petitioners in 1943 handled no less than 25 separate transactions involving 10 purchases and 15 sales of rental properties. It is significant that 7 of the 10 properties purchased in 1943 were resold within two months after the date of purchase. Although petitioners offer various reasons to account for the sale of these properties, we regard such a rapid turnover of properties, all at a profit, as inconsistent with the concept of investing in real property for the purpose of securing rental income.

In the calendar years 1942, 1943, and 1944 petitioners sold a total of 27 different real properties, all at a profit. Three properties were sold in 1942 for \$30,700, from which net gains of \$5,169.24 were realized. In 1943, they sold 15 parcels for \$263,433.99, from which they derived net gains of \$50,894.64. In contrast, petitioners reported net rental income of \$11,287.58 and \$16,958.08 for 1942 and 1943, respectively. In 1944 nine properties were sold.

⁴ Evidence of sales in years subsequent to the taxable year involved is relevant as showing that the sales in the taxable year were not isolated and involuntary but of sufficient frequency and continuity to constitute the carrying on of a business. *Ehrman v. Commissioner, supra*, p. 610.

These facts demonstrate that the transactions were of sufficient frequency, continuity and substantially to constitute the carrying on of a business.

Significantly, the taxpayer in his 1943 return reported his occupation to be that of "Realtor & Prop. Mgmt." (R. 101.) This admission lends strong support to the Tax Court's conclusion that he was engaged in the business of buying and selling real estate for his own account. *White v. Commissioner, supra; Oliver v. Commissioner, supra.*

If more were needed to support the Tax Court's conclusion, it is provided by taxpayer's own explanation of why real estate was so frequently and continuously bought and sold for his own account. The taxpayer testified (R. 82-86) that he bought with a view to reselling and using the sale proceeds to acquire larger properties.⁵

⁵ The taxpayer husband testified as follows (R. 82-83):

The Court: Mr. Field, as I understand, your objective has been to acquire a property with a large number of units.

The Witness: That is right.

The Court: And that was your objective a way back years ago, was it not?

The Witness: Yes, sir, back in——

The Court: And these smaller properties, as I understand it, you bought because they were the only ones that you had money to buy.

The Witness: To handle.

The Court: To handle. So wasn't it your idea that as you could get the larger unit that you were going to dispose of these properties and buy a larger unit with the money?

The Witness: That was the purpose of it.

The Court: That was the purpose. So these properties were bought, as I understand your testimony, with the idea of selling and acquiring money to buy a larger unit.

In this connection the Tax Court aptly observed (R. 35-36)—

Petitioners explain that these properties were purchased and held by them for investment with the idea of later selling them to acquire larger properties which they regarded as better investments. Petitioners' reasons for purchasing the various properties in question are of little significance if the sales were so extensive as to establish them in the business of selling real estate on their own account. * * *

Moreover, in view of the number of properties handled by the petitioners, this explanation actually indicates that they were in the business of buying and selling realty for a profit and using those profits to increase their investment in other rental property. * * * How a taxpayer may invest his profits would seem to have little bearing on the question of whether or not he is engaged in a trade or business.

The fact that taxpayer was a real estate broker (R. 28-29) does not prevent him from being also a dealer in real estate. A taxpayer may of course carry on more than one business (*Oliver v. Commissioner*; *Snell v. Commissioner*, both *supra*), particularly where, as here, we find the closely related ones of real estate broker and real estate dealer and the taxpayer repre-

The Witness: That is right.

He further testified as follows (R. 86) :

Q. Where did you expect to get the money to buy that larger apartment?

A. When the opportune time came to buy?

Q. Yes.

A. Then we would sell those equities to get it. That is what.

sents his business (R. 101) to be that of "Realtor." *White v. Commissioner, supra*. If the selling activities are frequent and continuous, involving substantial consideration and profits, they constitute in and of themselves the carrying on of a selling business; it is immaterial how much time the taxpayer devotes to such business, whether he conducts it personally or through agents, or whether he simultaneously works on other business. *Commissioner v. Boeing; Welch v. Solomon; Snell v. Commissioner; Greene v. Commissioner; Oliver v. Commissioner; White v. Commissioner*, all *supra*; *Fackler v. Commissioner*, 133 F. 2d 509 (C. A. 6th). True, as taxpayer asserts, he did not resell every piece of property acquired by him, but used a chosen few for rental income. The mere fact that taxpayer rented some properties does not preclude a finding that he was also engaged in the business of selling other rental properties. *Snell v. Commissioner; Greene v. Commissioner*, both *supra*. As the court stated in the *Snell* case (pp. 892-893):

This taxpayer must, to defeat [sic] his claim to a capital gains rate, have been in the business of selling his lands. An occasional sale of land held as an investment is not such a business though profit results. The word, notwithstanding disguise in spelling and pronunciation, means busyness; it implies that one is kept more or less busy, that the activity is an occupation. It need not be one's sole occupation, nor take all his time. It may be only seasonal, and not active the year round. It ordinarily is implied that one's own attention and effort are involved, but the maxim *qui facit per alium*

facit per se applies, and one may carry on a business through agents whom he supervises. The present taxpayer therefore does not demonstrate that he was not engaged in the business of selling lands because he also rented his buildings and operated a golf course; * * *.

Taxpayer's contention that the properties sold were held for investment, not for sale, is irreconcilable with the uncontradicted fact that (1) between 1942 and 1944 taxpayer sold no less than 27 properties, all at a profit; (2) during the taxable year 1943 alone, he sold 15 properties for \$263,433, at a profit of over \$50,000 as contrasted with a net rental income realized in that year of less than \$17,000; (3) seven of 10 properties purchased in 1943 were sold within two months after the purchase of each, and the profits were reported as short-term capital gains (R. 32, 34-35, 68-69, 118); (4) eight of the 19 properties previously purchased through Oxford Associates were unimproved, non-income producing lots, and taxpayer still held them for profitable resale (R. 30-31, 49, 59-63);⁶ (5) each of the nine properties sold in 1944 was an income-producing property (R. 74). Persons who buy property solely for investment do not waste their investment on non-income-producing lots, as a general rule; nor, if they buy income-producing property, do they subsequently resell it. Far from requiring the Tax Court to conclude as a matter of law that taxpayer purchased only for investment purposes, as taxpayer insists, these uncontradicted facts clearly warrant the

⁶ Taxpayer testified that he still owns 12 of the 19 properties received upon liquidation of Oxford Associates (R. 49, 59), and that 8 of these are non-income-producing lots (R. 62-63).

conclusion that taxpayer was engaged in the business of buying and selling real estate, both improved and unimproved. Certainly it cannot be said that the Tax Court's conclusion on this score was clearly erroneous. Nor is there any merit in taxpayer's contention (Br. 16 *et seq.*) that his purpose in acquiring the properties was that of investment rather than resale. Aside from the fact that the record indicates the contrary, taxpayer's reasons or motives in originally acquiring the properties resold are no more material than the fact that some of the properties were rented pending their sale. If—as was the case here—resales are frequent and continuous, the Tax Court is fully justified in concluding that the property was “held” primarily for resale in the ordinary course of business and hence excluded from the definition of capital assets. As the Court said in the *Richards* case, *supra* (p. 373)—

* * * we must assume that the intention of Congress as carried out was not to narrow this third class of property excluded, but was to include in the comprehensive word “held,” property which might or might not have been purchased primarily for the purpose of resale.

Again, in the *Ehrman* case, *supra*, the Court stated (p. 610)—

We fail to see that the reasons behind a person's entering into a business—whether it is to make money or whether it is to liquidate—should be determinative of the question of whether or not the gains resulting from sales are ordinary gains or capital gains. * * *

See also *Snell v. Commissioner, supra*.

Equally without substance is taxpayer's corollary contention (Br. 16-17, 24), that they cannot be deemed engaged in the business of buying and selling because the profits on the sales were used to buy rental properties. On the contrary, the fact that taxpayer used the profits from the sales to purchase other properties serves to confirm, rather than detract from, the correctness of the Tax Court's finding that he was as much engaged in the business of buying and selling real estate as he was in that of renting. Indeed taxpayer's profits from sales during the taxable year 1943 far exceeded net rental income. (R. 35.) As the Tax Court concluded (R. 35-36) "this explanation actually indicates that they were in the business of buying and selling realty for a profit and using those profits to increase their investments in other rental property."⁷ At any rate, whether a taxpayer carries on a selling business obviously does not depend upon how he disposes of the profits of that business. Even if the properties had been acquired for investment and sold for liquidation purposes, that would not preclude a determination that taxpayer was engaged in the business of selling. *Ehrman v. Commissioner, supra*; *Brown v. Commissioner, supra*. *A fortiori*, such a determination is warranted where, as here, the taxpayer

⁷ Taxpayer points (Br. 16) to the fact that he sold properties (at a profit of about \$27,000) producing a rental of \$1,900 and applied the proceeds toward the purchase of another property yielding a rental of \$4,600. But while the rental income from the property purchased was over twice that of the property sold, the cost of the new property (\$176,000) was about twice that paid for the old. (R. 30, 31, 32.) The proceeds of other rental property, all sold at a profit, were used to purchase property producing about the same rental. (R. 31-32.)

purchases numerous properties, resells them at a profit, and uses the sales proceeds to purchase other properties.

Taxpayer does not and cannot point to any authority which calls for reversal of the decision below. *Foran v. Commissioner*, 165 F. 2d 705 (C. A. 5th), upon which he relies (Br. 17), is not at all comparable and lends no support to his position. That case involved a single sale of oil producing properties, and as the court noted (p. 706), the Tax Court had made no finding that the taxpayer was engaged in the "business" of buying and selling. Nor did the record disclose any circumstance which in any way conflicted with the taxpayer's testimony that he had held the properties for investment, that he had never sold a producing oil property before, and had never offered the property for sale, and that he was forced by major oil companies to make the sale in question. The court agreed that the Tax Court was not bound to accept the taxpayer's explanation, if there were facts or circumstances indicating otherwise,⁸ but held that in the absence of any such facts, the Tax Court erred in disregarding it.

⁸ It is axiomatic that the trial judge is not required to accept uncontradicted testimony if there are any facts or circumstances which contradict it. *Quock Ting v. United States*, 140 U. S. 417, 420-421, 422; *Greenfeld v. Commissioner*, 165 F. 2d 318 (C. A. 4th). This rule applies even as to the taxpayer's testimony of intention. *Wilmington Co. v. Helvering*, 316 U. S. 164, 167; *Helvering v. Nat. Grocery Co.*, 304 U. S. 282, 295. The Tax Court is not bound to accept uncontroverted testimony "when there are facts which may even indirectly give rise to inferences contradicting the witness." *Cohen v. Commissioner*, 148 F. 2d 336, 337 (C. A. 2d).

No such situation is here presented, as already has been demonstrated. The undisputed facts show, and the Tax Court found, that taxpayer's buying and selling activities were so frequent and continuous as to amount to engaging in the "business" of buying and selling. Besides, the Tax Court did not disregard taxpayer's testimony; on the contrary, it accepted his explanation (R. 82-86) and properly concluded (R. 35-36) that "this explanation actually indicates that they were in the business of buying and selling realty for a profit and using those profits to increase their investments in other rental property." The Tax Court cases cited by taxpayer (Br. 19-21) are clearly distinguishable from the situation at bar.

Each case in this field necessarily turns on its own facts. If any comparison is to be drawn between this and other cases, then we submit that this case bears a closer resemblance to the cases cited, *supra*, in which the courts have sustained the Commissioner's and Tax Court's determinations that the gains represented ordinary income, than the ones cited by taxpayer.⁹ Indeed, the evidentiary support for the Tax Court's decision here appears even stronger than in others in which its findings have been upheld by this Court. Cf. *Ehrman v. Commissioner, supra*; *Richards v. Commissioner, supra*. In so far as the conclusions of the Tax Court are based upon conflicting evidence, they are binding upon this Court unless they are clearly

⁹ The decision of the Fifth Circuit in *Foran v. Commissioner, supra*, is to be contrasted, for example, with the decisions of the same court in *White v. Commissioner*; *Greene v. Commissioner*; *Brown v. Commissioner*; *Snell v. Commissioner*; *McFaddin v. Commissioner*, all *supra*.

erroneous. Internal Revenue Code, Section 1141 (a), as amended by Section 36 of the Act of June 25, 1948, c. 646, 62 Stat. 869; *Wright-Bernet, Inc., v. Commissioner*, 172 F. 2d 343 (C. A. 6th); *United States v. U. S. Gypsum Co.*, 333 U. S. 364, 393-396; *Tilghman v. Proctor*, 125 U. S. 136, 149; *Kimberly v. Arms*, 129 U. S. 512, 523-524; *Warren v. Keep*, 155 U. S. 265. Although this Court may draw a different inference from primary facts as found by the Tax Court, we submit that the ultimate finding of the Tax Court that taxpayer was engaged in buying and selling property held "primarily for sale to customers in the ordinary course of his trade or business" is the only inference that could have been drawn from the facts as found by the Tax Court.

CONCLUSION

In view of the foregoing, it is submitted that the Tax Court's decision is correct both in fact and law, and should be affirmed.

Respectfully submitted,

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DECEMBER, 1949.

APPENDIX

INTERNAL REVENUE CODE:

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

* * * *

(26 U. S. C. 1946 ed., Sec. 111.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital assets.*—The term “capital assets” means property held by the taxpayer (whether or not connected with his trade or business), but does not include * * * property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business * * * ;

* * * *

(b) [As amended by Sec. 150 (c), Revenue Act of 1942, c. 619, 56 Stat. 798] *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

* * * *

(26 U. S. C. 1946 ed., Sec. 117.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.117-1. *Meaning of Terms.*—The term “capital assets” includes all classes of property not specifically excluded by section 117 (a) (1). In determining whether property is a “capital asset,” the period for which held is immaterial.

* * * * *

However, gain or loss upon the sale or exchange of land held by a taxpayer primarily for sale to customers in the ordinary course of his business, as in the case of a dealer in real estate, is not subject to the limitations of section 117 (b), (c), and (d). The term “ordinary net income” as used in these regulations for the purposes of section 117 means net income exclusive of gains and losses from the sale or exchange of capital assets.

* * * * *

No. 12,308

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

EDDY D. FIELD and HELEN FIELD,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REHEARING.

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FILED

MAK 28 1950



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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REHEARING.

To the Honorable Judges of the United States Court of Appeals, for the Ninth Circuit:

The petitioners in the above entitled cause present this their petition for a rehearing of the above entitled cause, and, in support thereof, respectfully show:

I.

The opinion of the Tax Court of the United States which was affirmed and adopted by this Court is wrong for two reasons:

- (1) The finding that the properties in question were held primarily for sale to customers in the ordinary course of taxpayer's trade or business is not supported by any evidence; and

- (2) The Tax Court's conclusion of law is contrary to the law as subsequently announced by the Tax Court in the case of *Nelson A. Farry*, 13 T. C., No. 3, which latter decision has been acquiesced in by the Commissioner of Internal Revenue.

II.

Section 117(a)(1) of the Internal Revenue Code defines capital assets as "Property held by the taxpayer (whether or not connected with his trade or business)", with a number of exclusions. Of these exclusions, the one with which we are concerned herein provides that an asset is not a capital asset if it is

"property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

This exclusion from the category of capital assets, together with the closely related exclusions of stock-in-trade or property includable in inventory, helps to reveal the statutory design and intent of the Code decisions distinguishing between capital and non-capital assets. These exclusions apply to the property which a merchant carries for sale to the public, and the property which a dealer "holds for sale to customers." The sales so made are part of "the trade or business" of the taxpayer and are of a continuing or recurring nature. Profits resulting are of the same general nature as income from personal services, rent, dividends, and the like, and should receive the same treatment. On the other hand, an asset held by an "investor" is not held "primarily for sale to customers in the ordinary course of his trade or business." Such an investor usually holds property for the income which it produces or for long-term appreciation in value,

or both, and does not hold it for regular sales to customers. Assets so held by investors are capital assets.

This Court is well aware of the fact that this section of the Internal Revenue Code has produced much litigation, the reason probably being that the language of the statute itself is in general terms and of indefinite meaning. The phrase "primarily held" connotes uncertainty and the phrase "ordinary course of his trade or business" imports very little specific meaning by itself.

Section 117(j) of the Code was added by the Revenue Act of 1942 and is a remedial provision. Under its provisions the sale of real estate results in a Section 117(j) gain or loss even though it was used in the taxpayer's business if it was held for more than six (6) months, providing, however, that it was not held primarily for sale to customers in the ordinary course of taxpayer's business.

III.

In determining whether an asset is one held for investment or primarily for sale, it is submitted that it is important to know:

- (1) How and why the taxpayer acquired the asset;
- (2) What he did with it over a period of time; and
- (3) How and why he disposed of it.

In this case the taxpayer sold eight pieces of property in 1943 which he claims were purchased and held as investment properties for rental income and upon which he reported the profit at capital gain rates. True in 1943 he sold seven other pieces of property which he held less than six months and upon which he reported the entire profit. This he had to do whether the properties were

capital assets or non-capital assets. The burden of proof of petitioners, however, was only to prove that the eight properties sold upon which the Commissioner denied capital gain treatment was erroneous. All of the properties but one had been held by petitioners for five to eight years. This one property had been held for a year and a half.

IV.

Petitioner had never held himself out as a dealer and his primary business was buying and selling properties for others on a commission basis. Petitioner, Eddy Field, testified that they organized a corporation in 1934 to hold properties which they were acquiring for investment. Their profits from the brokerage business were small but it was these profits that they used to purchase investment properties. Seven of the eight properties in question were so purchased and held by the corporation. The petitioner testified [Record p. 83] that in buying these properties they assumed very heavy loans and that from the rents from the properties they increased their equities, as well as by the profits of the brokerage business. One who is holding property primarily for sale does not ordinarily reduce the obligations against such property. Petitioner specifically testified that as to each of the eight properties involved they were purchased for investment and rental income and further explained that the reason for the sale of the properties in 1943 was

- (1) as to seven of the properties, they were sold because petitioners had an opportunity to buy what they considered better investment property; and
- (2) the other, that it had become an undesirable investment due to change in the neighborhood.

V.

Let us examine the Tax Court's opinion upon which this Court affirmed. The Tax Court says [Record p. 34]:

"To ascertain whether petitioners were engaged during the taxable years in the business of selling real estate on their own account, we must examine all of the transactions during those years and not only those from which petitioners reported the profit as long-term capital gain."

It is submitted that this is not a correct statement of the law. It might be if all of the other properties sold were of the same type and purchased for the same reason as the eight in question, but no foundation was laid by respondent upon which that argument can rest. Petitioners' burden was to prove that the eight properties upon which they claimed capital gain were properties held for investment and rental income and not primarily for sale and if they proved that, that is as far as their burden went. That was exactly the problem before the Tax Court in the later case of *Nelson A. Farry, supra*. In that case the Tax Court held that the many sales of investment properties in the same manner as the properties which the taxpayers held primarily for sale to customers in the ordinary course of their trade or business, was not the determining factor with respect to the investment properties. Moreover, every investor who sells property sells for his own account. The fact that he sells for his own account does not convert a capital asset into a non-capital asset.

The Tax Court further says [Record p. 35]:

"* * * We regard such a rapid turnover of properties, all at a profit, as inconsistent with the concept of investing in real property for the purpose of securing rental income."

The fact that all eight properties in question were sold at a profit is explained by petitioner [Record p. 75] where he said that the condition of the market in 1943 was such that any properties acquired six or eight or ten years before would have to show a gain. It would appear that the Court can take judicial notice of the fact that property bought in 1934, 1935 and 1936, as were these properties, were bought during a low market period, and that property such as those in question in 1943, a War year, in Los Angeles had a much higher market value. The eight properties in question had not been rapidly turned over. They had been held for several years and all of them were producing rental income, and taxpayer had increased his equities in those properties from the rentals received and from the profits of his brokerage business. Are not those uncontradicted facts consistent with concepts of investing in real property rather than holding those particular properties primarily for sale to customers?

The Tax Court further states [Record p. 35]:

“That petitioner’s reason for purchasing the eight properties in question are of little significance if the sales were so extensive as to establish them in the business of selling real estate on their own account.”

It is submitted that that expression of the Court is exactly contrary to the later expression of the Tax Court in the *Farry* case, *supra*. It overlooks entirely the fact that a person may be an investor as to some properties, and hold others primarily for sale to customers. In that case the taxpayer was active in the sale of houses and lots in subdivisions which he had developed and he also held large numbers of low grade buildings for the rental income they produced. In 1944 and 1945 as a result of the land values and increased demand for housing he

decided to sell his rental properties. He sold nineteen in 1944 and twenty-seven in 1945. Most of them had been held for over a year, and some for as long as eleven years. The Commissioner contended that the profits from the sale of the rental property were taxable as ordinary income contending that petitioner was holding rental property primarily for sale to customers in the ordinary course of his trade or business. The Tax Court held that the profits had been properly returned as capital gains; that they had been bought and were held primarily for investment, and not for sale to customers in the ordinary course of business. The fact that the taxpayer was also a dealer in real estate was also immaterial. The Court, stating that if petitioner was holding the properties primarily for sale to customers they were not capital assets, said:

“However, it seems to us that petitioner has proved by overwhelming evidence that he purchased and held these properties primarily for investment purposes. The fact that in the taxable years he received satisfactory offers for some of them and sold them does not establish that he was holding them ‘primarily for sale to customers in the ordinary course of his trade or business.’ The evidence shows that he was holding them for investment purposes and not for sale as a dealer in real estate.”

The Commissioner of Internal Revenue acquiesced in the Tax Court’s decision in the *Farry* case (see Prentice-Hall Federal Tax Service, Volume 4, 1950, No. 76, 216).

VI.

The respondent relied heavily in this Court and in the Tax Court upon the decisions of this Court in *Ehrman v. Commissioner*, 120 F. 2d 607, and *Richards v. Commissioner*, 81 F. 2d 369. They were also relied upon by the

Tax Court. It is submitted that those decisions are wholly inapplicable to the facts of this case. In the first place they both involve cases in which the taxpayers had subdivided tracts of land and sold many lots. Their only contention in this Court was that the sales were being made in order to liquidate the asset. All the Court held in those cases was that the motive of liquidation did not prevent the taxpayers from being engaged in a trade or business where they were actively subdividing, platting and developing property for sale. It is submitted that the decisions go no further than that.

Respondent relies upon the taxpayer's testimony in answer to some of the Court's questions [Record pp. 82-86] to the effect that in buying small properties they intended sometime to sell them when they were financially able to buy larger and better investment properties. The mere fact that a taxpayer buys a property for investment but admits that at some future date he will sell them either when he can realize a substantial profit or when he decides to dispose of them to buy a more desirable investment, does not mean that he is holding the property primarily for sale to customers in the ordinary course of his business. That is all the taxpayer testified to, namely, that he bought for investment properties because that was all he could afford to buy. He intended at some future date to own larger investment properties which would pay him better income and when he was able to do so, he would sell. It is submitted that that is what all investors do with investment property. They sell when they can better their investment and realize a profit. It does not follow it is respectfully submitted that just because they intend at some future time to dispose of them that they are holding

them "primarily for sale to customers in the ordinary course of their trade or business."

Petitioners agree with that part of the Tax Court's opinion in which they state [Record p. 36]:

"How a taxpayer may invest his profits would seem to have little bearing on the question of whether or not he is engaged in a trade or business."

However, it is evidence of why petitioners sold their investment properties which they had held for several years. They sold them just to secure better investments, which is what every investor does, if he can.

VII.

Reflection will show the inequity of the Court's determination. It was testified, and there is no contradiction, that these eight properties were purchased by petitioners over a period of years from their surplus earnings in the brokerage business. Those surplus earnings represented their annual savings from this business; they invested in real estate; they held the real estate seven or eight years; they used the rents to increase their equities; then in 1943 they sold them. The monies which petitioners had in these eight properties represented their savings or investments. Whatever profit was realized on their sale was not an appreciation of value in 1943 but an appreciation in value over the period of time they were held. That is the very reason for the capital gain provisions of the Code, namely not to tax at 100 per cent the profits on investments which represent an appreciation over a period of time. Congress has seen fit to make that period in the current law six months. Previous Acts had fixed the time at eighteen months and two years. In other words, the result of the Court's decision is to tax petitioners in 1943 on

100 per cent of the profit they have made on their savings. Had petitioners invested their earnings in stocks or bonds and sold them in 1943 the Respondent would have determined they were sales of capital assets. Real estate is as much a capital asset under the Statute as are stocks and bonds.

Petitioners think it appropriate to state that the decision of this Court affirming the Tax Court in this case leaves the law in this Circuit unsettled. Petitioners' counsel is advised by responsible Bureau representatives that there are very many cases of the same kind which were being held up for settlement pending the decision of this Court in this case; that as a result of this Court's opinion in the case at Bar the law in this Circuit is unsettled. Taxpayers with similar cases are relying upon the Tax Court's opinion in the *Farry* case, *supra*, in which the Commissioner has published his acquiescence. On the other hand, the Commissioner can rely in this Circuit at least on this Court's decision in this case.

VIII.

Petitioner was the only witness. Respondent offered no evidence. He testified positively that he had never held himself out as a dealer in real estate; that he purchased the eight properties here in question out of his earnings as a broker and invested those earnings in the properties in question; that he bought them for investment and rental income; that he applied the rents against the encumbrances to increase his equities; that he held them for a period of several years; that none of his employees in his brokerage offices had anything to do with the sales of the properties in question, from which it may be assumed that they were not listed by him for sale and that he only sold them in 1943 to purchase properties which he

regarded as better investments. He likewise testified positively [Record p. 58] that he never held these properties primarily for sale to customers in the ordinary course of his business. His testimony was unimpeached and was not contradicted by the testimony of any other witness or by any other fact actually proved and is not inherently improbable. Petitioners are not asking this Court to resolve in their favor two conflicting theories each theory having some evidence in the record to sustain it, but is asking this Court to make the only finding it is possible under the uncontradicted evidence to make, namely, that the eight properties in question were held by the petitioners for investment and rental income and were not held primarily for sale to customers in the ordinary course of trade or business. This Court held in the case of *Grace Bros., Inc. v. Commissioner*, 173 F. 2d 170 at 174, that it is axiomatic that uncontradicted testimony must be followed, the only exception being where we are dealing with testimony by witnesses who stand impeached and whose testimony is contradicted by the testimony of others or by physical or other facts actually proved, or with testimony which is inherently improbable.

Wherefore, upon the foregoing grounds, it is respectfully urged that this Petition for a rehearing be granted, and that the decision of the Tax Court of the United States be upon further consideration reversed.

Respectfully submitted,

GEORGE BOUCHARD,
Counsel for Petitioners.

Certificate of Counsel.

I, George Bouchard, Counsel for the above-named petitioners, do hereby certify that the foregoing Petition for a rehearing of this cause is presented in good faith and not for delay.

Dated: March 27, 1950.

GEORGE BOUCHARD.

No. 12309

United States
Court of Appeals
For the Ninth Circuit.

WIL-RUD CORPORATION,

Appellant.

VS.

E. A. LYNCH, Receiver and Trustee of the Estate
of California Associated Products Co., AARON
LEVINSON, VICTOR KRAMER, BANK OF
AMERICA NATIONAL TRUST AND SAV-
INGS ASSOCIATION, F. W. BOLTZ
CORP., and LEO BRILL,

Appellees.

Transcript of Record

Appeals from the United States District Court,
Southern District of California,
Central Division.

FILED
DEC 22 1949

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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For Appellee Leo Brill:

MAURICE M. GOODSTEIN,
739 S. Hope St.,
Los Angeles, Calif.

In the District Court of the United States, Southern
District of California, Central Division

Number 45,137-BH

In the Matter of

CALIFORNIA ASSOCIATED PRODUCTS CO.,
a corporation, and also doing business as
YANKEE DOODLE ROOT BEER BOT-
TLING COMPANY,

Debtor.

ORDER CONFIRMING AND APPROVING
SALE

The debtor in the within proceeding having filed a petition seeking relief under the provisions of Chapter XI of the Bankruptcy Act, and having failed to submit for confirmation a plan of arrangement accepted by majority in number and amount of the unsecured creditors, and having announced through its counsel, Nat Rosin, that it had no objection to the sale as hereinafter set forth, and had no presently acceptable plan of arrangement to submit to the Court, and the matter of the submission of plans and of offers to purchase certain assets, hereinafter described, having been considered by this Court and the Creditors through the Committee of Creditors from time to time, and particularly at hearings held before this Court on September 25, 1947, October 7, 1947, and October 15, 1947, the Receiver, E. A. Lynch, being present and represented by Martin Gendel, of counsel, and the

Committee of Creditors being present in person, and the purchaser being represented by Charles J. Katz as his attorney, and it further appearing that the sale of the personal property hereinafter described is for the best interests of the within estate, and is made pursuant to the general powers conferred under the provisions of the Bankruptcy Act upon the undersigned as Referee, and is not made as any part of a plan or arrangement made or offered by or on behalf of the debtor, (all plans or arrangements having been rejected by the Court and the Committee of Creditors), and various bids having been submitted in open Court and the purchaser herein having been the highest and best bidder in open Court, and the Committee of Creditors being present in open Court and having given its consent hereto in open Court;

Now, Therefore, the undersigned Referee does hereby approve and confirm the sale by E. A. Lynch, as Receiver in the within estate, of certain personal property, hereinafter described, to Wil-Rud Corporation, a corporation, for a cash consideration to be paid to said E. A. Lynch, as Receiver, in the sum of \$161,000.00, delivery of the assets to be made upon the signing of the within order, and payment therefor to be made concurrently with delivery to the buyer.

1. The Receiver, by this order, is deemed to have sold, and does sell to the buyer, all machinery, fixtures, equipment, all inventory, all lessee's improvements, all furnishings, all supplies, and all finished

and unfinished products of every class and character and description whatsoever located at 3631 Union Pacific Avenue, Los Angeles, California, together with all the other physical assets of the debtor corporation, wheresoever situated, and together with all of the physical assets of every class and character of the Yankee Doodle Root Beer Company, a corporation, as of October 15, 1947, at 5:00 o'clock P.M.; all of said items are sold free and clear of any liens, charges, and encumbrances, save and except a balance owing on a sales contract to the Los Angeles Water Softener Company in the sum of \$1,699.17, which balance the purchaser assumes and agrees to pay.

2. By this order the Receiver does transfer to the buyer all right, title and interest which this estate has in and to the lease covering the premises occupied by the debtor at 3631 Union Pacific Avenue, Los Angeles, California with the further provision that if Lowell E. Thompson and/or William F. Greene now have, or shall have, any arrangement or understanding, express or implied, with the owner of said premises for the obtaining of a lease upon said premises, or any extension thereof, that then such right shall inure to the benefit of the purchaser hereof, and with the further provision that the Court will make such orders as may be necessary to cause said Lowell E. Thompson and/or William F. Greene to transfer and assign unto the purchaser all such arrangements or understandings.

3. By this order there shall be transferred to

the purchaser, and the Receiver does hereby transfer to the purchaser, all of the issued and outstanding shares of the capital stock of the Yankee Doodle Root Beer Company, a corporation.

4. By this order there shall be and hereby is conveyed and transferred to the purchaser all ownership, right, title and interest which this estate has, or may have, or claims to have in and to any patents, processes, formulae, good will, copyright, trade names, trade marks, royalties, and/or licensing agreements, whether in the name of the debtor herein, towit, California Associated Products Co., or Yankee Doodle Root Beer Bottling Company, or Yankee Doodle Root Beer Company, a corporation, which by way of specification, and not by way of limitation, shall and does include the particular and specific formula or formulae, or process or processes for the concentrate used in the manufacture of the root beer known as Yankee Doodle Root Beer and manufactured and sold by California Associated Products Co., the debtor herein, or Yankee Doodle Root Beer Bottling Co., or Yankee Doodle Root Beer Co., a corporation, or any of them.

5. The estate and the receiver herein are not transferring or selling to the aforesaid purchaser any of the following items: any interest in and to choses in action existing on behalf of the estate; cash in the possession of the receiver as of the close of business on October 15, 1947; accounts receivable created by the debtor prior to the commencement of

the reorganization proceedings; accounts receivable created by the receiver since the commencement of the reorganization proceedings, and to and including the 15th day of October, 1947; that certain promissory note of Loma Linda Food Company and the Yankee Doodle Root Beer Company, upon which a balance of approximately \$4,300.00 is now owing; any claims for the cash surrender value of life insurance upon Messrs. Thompson and Greene arising from payment of premiums by debtor; or any of the insurance policies covering the physical assets transferred herein or issued to, or standing in the name of California Associated Products Co., the debtor herein, or Yankee Doodle Root Beer Bottling Co., or Yankee Doodle Root Beer Co., a corporation, or any of them, or in or to any of the unexpired premiums of the same or any part thereof; or any rights on behalf of the within estate to the items pledged as security by the debtor with the Bank of America National Trust & Savings Association, Monarch Wine Company and Raisin Syrup Company.

Dated: October 22, 1947.

/s/ HUGH L. DICKSON,

Referee in Bankruptcy.

Approved:

CHARLES J. KATZ,

By /s/ SAMUEL W. BLUM,

As Counsel for Wil-Rud
Corporation.

[Endorsed]: Filed Oct. 22, 1947.

[Title of District Court and Cause.]

PETITION FOR ORDER TO SHOW CAUSE
RE: WIL-RUD CORPORATION SALE

To the Honorable Hugh L. Dickson, Referee in
Bankruptcy:

Comes now your petitioner E. A. Lynch, and
respectfully represents as follows:

I.

That he is the duly appointed, qualified and acting
Receiver in the within proceedings.

II.

That heretofore an order confirming and approv-
ing a sale to Wil-Rud Corporation was made and
signed on the 22nd day of October, 1947; in sub-
stance, among other things, said order provided in
paragraph 1 thereof that the physical assets of the
debtor corporation and of Yankee Doodle Root Beer
Bottling Company, a subsidiary corporation, were
sold to Wil-Rud Corporation as of October 15, 1947,
at 5 o'clock p.m.

III.

That said order confirming and approving sale
provided for the sum of \$161,000.00 to be paid upon
the signing of said order, and to date, no sum, save
and except the sum of \$100,000.00 has been paid to
your petitioner, and the balance in the sum of \$61,-
000.00 is now due, owing and unpaid; that your
petitioner has been informed by Wil-Rud Corpora-
tion that it desires adjustments on the basis that

pursuant to an inventory prepared by your petitioner, certain items of personal property are now claimed by said purchaser to be missing, in the gross sum of \$15,488.99, and that there are certain errors in addition on the inventory, totalling \$3,463.17, making a total difference claimed of \$18,952.16.

IV.

That your petitioner is informed and believes, and therefor alleges, that the physical assets of the debtor as of 5 o'clock p.m., October 15, 1947, and pursuant to the order confirming and approving sale, have all been tendered to the purchasing corporation, and that all things to be performed by your petitioner to conclude said sale have been performed, and the said \$61,000.00 is now due and payable to your petitioner without any allowance of offsets on behalf of said Wil-Rud Corporation; that the sale to the said Wil-Rud Corporation was not predicated upon any inventory either as to items or additions; that said sale was made solely in accordance with the order confirming and approving sale.

Wherefore, your petitioner prays that this court make an order directing Wil-Rud Corporation to show cause why the said \$61,000.00 should not be forthwith paid.

/s/ E. A. LYNCH,

Petitioner.

GENDEL & CHICHESTER,

By /s/ MARTIN GENDEL,

of Counsel for Petitioner.

State of California,
County of Los Angeles—ss.

E. A. Lynch being by me first duly sworn, deposes and says: that he is the Petitioner in the above entitled action; that he has read the foregoing Petition for Order to Show Cause Re: Wil-Rud Corporation Sale and knows the contents thereof; and that the same is true of his own knowledge, except as to the matters which are therein stated upon his information or belief, and as to those matters he believes it to be true.

/s/ E. A. LYNCH.

Subscribed and sworn to before me this 31 day of October, 1947.

[Seal] /s/ M. E. MANUAL,
Notary Public in and for said County and State of California.

[Endorsed]: Filed Oct. 31, 1947.

[Title of District Court and Cause.]

ORDER TO SHOW CAUSE RE: WIL-RUD
CORPORATION SALE

To Wil-Rud Corporation, a corporation, and to
Charles J. Katz, its attorney:

You and Each Of You Will Please Take Notice, that pursuant to the petition of E. A. Lynch, dated October 31, 1947, a copy of which is attached hereto, the Wil-Rud Corporation is directed to appear be-

fore the undersigned Referee, in his courtroom located on the 3rd floor of the Federal Building, Los Angeles, California, on the 7th day of November, 1947, at the hour of 10 A.M., then and there to show cause why the petition as prayed for should not be granted, and why the said Wil-Rud Corporation should not be forthwith directed to pay the sum of \$61,000.00.

The Within Order To Show Cause, and petition attached hereto, may be served by delivering or mailing same to the office of Charles J. Katz on or before the 1st day of November, 1947.

Dated this 31st day of Oct., 1947.

/s/ HUGH L. DICKSON,
Referee in Bankruptcy.

[Endorsed]: Filed Oct. 31, 1947.

[Title of District Court and Cause.]

PETITION FOR LEAVE TO COMPROMISE
RE: WIL-RUD CORPORATION SALE

To the Honorable Hugh L. Dickson, Referee in
Bankruptcy:

Comes now your petitioner, E. A. Lynch, and
respectfully represents as follows:

I.

That he is the duly appointed, qualified and acting
receiver in the within reorganization proceedings.

II.

That heretofore, and on or about the 15th day of
October, 1947, Wil-Rud Corporation purchased cer-
tain assets of the debtor corporation at a sale held
in open court; that the purchase price was the sum
of \$161,000.00; that since said 15th day of October,
1947, certain differences have arisen between the
said purchaser and your petitioner, which differ-
ences can be summarized somewhat as follows:

(a) The purchaser contended that it bought all
of those physical assets reflected by that certain in-
ventory filed in the within debtor proceedings, which
inventory is designated as "Respondent's Exhibit
No. 2" introduced at the hearing on the petition of
the receiver for an order to show cause directed
against the purchaser, held before this Court on
the 7th day of November 1947; that during said
proceedings Wil-Rud Corporation contended that it

was entitled to an adjustment on inventory shortages in the sum of \$19,336.86; thereafter, Wil-Rud Corporation presented their contentions, particularly in connection with page 88-a of said inventory, wherein there was itemized a total of approximately \$47,976.29 worth of root beer bottles and cases, alleged to be in the vicinity or territory of Los Angeles, California, and, in connection therewith, Wil-Rud Corporation alleges that the debtor has taken deposits of 60c per case, and that said deposits are reflected by the fact that each of the customers having possession of the cases and bottles therein have a lien by virtue of the possession thereof until the said 60c is repaid; in addition thereto, the purchaser has alleged other variances and claims in connection with the sale, contending that it has paid certain warehousing and other charges on items which were purportedly sold free and clear.

(b) That it is the contention of your petitioner that the assets were sold "where is, as is" as of October 15, 1947, but your petitioner does allege that there is merit to the claims of the purchaser, particularly since the issues as to the inventory shortages were submitted to this Court on the 7th day of November, 1947, and this Court has indicated that it would determine the matter in favor of the purchaser.

III.

That after a full and complete interchange of facts, your petitioner and his counsel have conferred with the purchaser and its counsel in an effort to

determine whether or not a compromise and settlement could be reached so that the administration of the within estate could be brought to a termination; that after negotiations and conferences, the following compromise and settlement has been offered by the purchaser, and is now being recommended to this Court by your petitioner as apparently being for the best interests of the within estate, subject to the approval of this Court:

1. The purchaser is to be allowed a credit upon the purchase price herein in the sum of \$18,500.00 making the total purchase price payable in the sum of \$142,500, less a credit of \$125,000, heretofore paid, leaving a present balance now due and payable, and to be paid upon the approval of the within petition for leave to compromise, in the sum of \$17,500.00.

2. The purchaser does, concurrently herewith, make an offer to purchase all outstanding accounts receivable of the within estate, as per that certain itemization approved by the purchaser and the receiver on December 22, 1947, and specifically excluding therefrom the accounts receivable which the estate now has with Messrs. Thompson, Green, Tanner & Harold Brooks, and likewise excluding therefrom the accounts receivable owing to the estate from California Marmalade Company, Pacific Associated Products Company, and Loma Linda; said offer of purchase is in the sum of \$3,500.00, and the purchaser, in connection therewith, agrees to hold your petitioner harmless on any claims for refunds

on cases and/or bottles up to 60c per wooden case containing 24 bottles, for each such case and/or bottles surrendered up to purchaser.

3. The purchaser will declare compromised and settled in full any and all claims of any nature against the within estate, or the receiver herein, arising from the aforesaid sale, and the receiver will likewise declare compromised and settled any and all claims of any nature arising on behalf of the within estate, or the receiver, as against the purchaser, save and except for the performance of the items contained in paragraphs 1 and 2 herein-above.

Wherefore, your petitioner prays that after due notice to creditors a hearing be held and that the within petition for leave to compromise be approved.

Dated: December 26, 1947.

/s/ E. A. LYNCH,

Receiver,

Petitioner.

GENDEL & CHICHESTER,

By /s/ MARTIN GENDEL,

of counsel for receiver.

Approved:

/s/ CHARLES J. KATZ,

Attorney for Wil-Rud

Corporation.

State of California,

County of Los Angeles—ss.

E. A. Lynch being by me first duly sworn, deposes and says: that he is the petitioner in the above

action; that he has read the foregoing Petition For Leave To Compromise Re: Wil-Rud Corporation Sale, and knows the contents thereof; and that the same is true of his own knowledge, except as to the matters which are there stated upon information or belief, and as to those matters he believes it to be true.

/s/ E. A. LYNCH.

Subscribed and sworn to before me this 31st day of December, 1947.

[Seal] /s/ DORIS E. EDWARDS,
Notary Public in and for said County and State of
California.

My Commission Expires Sept. 17, 1950.

[Endorsed]: Filed Jan. 6, 1948.

[Title of District Court and Cause.]

· NOTICE OF HEARING ON PETITION TO
COMPROMISE AND SALE OF ACCOUNTS
RECEIVABLE

To the Creditors of the above named Debtor Estate:

Notice Is Hereby Given that on January 29, 1948 at 10:00 A.M. at the courtroom of the undersigned Referee in Bankruptcy, 339 Federal Building, Temple and Spring Streets, Los Angeles, California, a meeting of creditors will be held to hear the petition of E. A. Lynch, the Receiver herein, to compromise the following:

That heretofore, and on or about the 15th day of October, 1947, Wil-Rud Corporation purchased certain assets of the debtor corporation at a sale held in open court; that the purchase price was the sum of \$161,000.00; that since said 15th day of October, 1947, certain differences have arisen between the said purchaser, the Wil-Rud Corporation, and the Receiver;

(a) The Wil-Rud Corporation contended that it bought all of those physical assets reflected by that certain inventory filed in the within debtor proceedings, which inventory is designated as "Respondent's Exhibit No. 2" introduced at the hearing on the petition of the receiver for an order to show cause directed against the Wil-Rud Corporation, held before the Court on the 7th day of November, 1947; that during said proceedings Wil-Rud Corporation contended that it was entitled to an adjustment on inventory shortages in the sum of \$19,336.86; thereafter, Wil-Rud Corporation presented their contentions, particularly in connection with page 88-a of said inventory, wherein there was itemized a total of approximately \$47,976.29 worth of root beer bottles and cases, alleged to be in the vicinity of territory of Los Angeles, California, and, in connection therewith Wil-Rud Corporation alleges that the debtor has taken deposits of 60c per case, and that said deposits are reflected by the fact that each of the customers having possession of the cases and bottles therein have a lien by virtue of the possession thereof until the said 60c is repaid; in

addition thereto, the Wil-Rud Corporation has alleged other variances and claims in connection with the sale contending that it has paid certain ware-housing and other charges on items which were purportedly sold free and clear.

(b) That it is the contention of the Receiver that the assets were sold "where is, as is" as of October 15, 1947, but the Receiver does allege that there is merit to the claims of the Wil-Rud Corporation, particularly since the issues as to the inventory shortages were submitted to this Court on the 7th day of November, 1947, and this Court has indicated that it would determine the matter in favor of the Wil-Rud Corporation.

The Wil-Rud Corporation has offered the following compromise:

The Wil-Rud Corporation is to be allowed a credit upon the purchase price herein in the sum of \$18,500.00 making the total purchase price payable in the sum of \$142,500, less a credit of \$125,000, heretofore paid, leaving a present balance now due and payable, and to be paid upon the approval of the within petition for leave to compromise, in the sum of \$17,500.00.

2. The Wil-Rud Corporation offers to purchase for the sum of \$3,500.00 all outstanding accounts receivable of the within estate, as per that certain itemization approved by the Wil-Rud Corporation and the Receiver on December 22, 1947 with the following exceptions:

Accounts with Messrs. Thompson, Green, Tanner and Harold Brooks and the accounts receivable owing to the estate from the California Marmalade Company, Pacific Associated Products Company and Loma Linda;

The Wil-Rud Corporation agrees to hold the Receiver harmless on any claims for refunds on cases and/or bottles up to 60c per wooden case containing 24 bottles, for each such case and/or bottles surrendered up to the Wil-Rud Corporation.

The Wil-Rud Corporation will declare compromised and settled in full any and all claims of any nature against the within estate, or the Receiver herein, arising from the aforesaid sale, and the Receiver will likewise declare compromised and settled any and all claims of any nature arising on behalf of the within estate, or the Receiver, as against the Wil-Rud Corporation, save and except for the performance of the items contained in the above paragraphs.

The Receiver believes that it is to the best interests of said estate that said compromise be approved.

For further information, see petition on file in the office of the undersigned Referee in Bankruptcy.

HUGH L. DICKSON,
Referee in Bankruptcy.

Dated: January 14, 1948.

[Title of District Court and Cause.]

FINDINGS OF FACT, CONCLUSIONS OF
LAW, and ORDER APPROVING PETI-
TION FOR LEAVE TO COMPROMISE
WIL-RUD CORPORATION SALE

Pursuant to the verified petition of E. A. Lynch, as receiver in the within Chapter XI, proceedings, dated January 6, 1948, seeking leave to compromise claims made by Wil-Rud Corporation, and after duly noticing same, in writing, to all creditors as required by law, a hearing was held before the undersigned Referee, in his courtroom located on the 3rd floor of the Federal Building, Los Angeles, California, on January 29, 1948, at the hour of 10 a.m.; at said hearing E. A. Lynch, the Receiver, was present and represented by Martin Gendel, of counsel, and the purchaser, Wil-Rud Corporation was present, and represented by its counsel, Chas. J. Katz, and the various creditors and their representatives were present, particularly those creditors represented by attorneys Frank T. Cotter, Hugh Ward Lutz, Aaron Levinson and Hugo Steinmeyer; after evidence, both oral and documentary, was duly introduced, and the objections of various creditors and the recommendations of the Receiver were considered, and after the arguments of counsel were duly submitted, and good cause appearing therefor, the undersigned Referee does hereby make the following Findings of Fact, Conclusions of Law and Order:

FINDINGS OF FACT

1. The undersigned Referee finds that the allegations contained in paragraphs I and II of the petition of E. A. Lynch, above referred to and dated January 6, 1948, for leave to compromise problems involved in the Wil-Rud Corporation sale, are true.

2. The undersigned Referee further finds that the Wil-Rud Corporation could reasonably contend that it was entitled to total adjustments in the sum of approximately \$28,000.00, and without passing further on the merits of said claims at this time, the undersigned Referee finds it would be for the best interests of the within estate to permit the compromise and settlement of the pending litigation and further claims on the basis of allowing a reduction of the purchase price in the sum of \$18,500.00, thereby reducing the purchase price to the sum of \$142,500.00, leaving a present balance due and payable, upon the signing of this Order in the sum of \$17,500.00; the purchaser, Wil-Rud Corporation having heretofore paid to the Receiver, E. A. Lynch, the sum of \$125,000.00 on account of the purchase price. It further appears that some of the creditors now objecting to the compromise submitted and approved a bid of \$135,000.00 to this Court on October 15, 1947, and requested this Court not to accept any higher bid; the undersigned Referee further finds that on November 7, 1947, this Court considered some of the claims of Wil-Rud Corporation concerning alleged shortages, and in-

[Title of District Court and Cause.]

FINDINGS OF FACT, CONCLUSIONS OF
LAW, and ORDER APPROVING PETI-
TION FOR LEAVE TO COMPROMISE
WIL-RUD CORPORATION SALE

Pursuant to the verified petition of E. A. Lynch, as receiver in the within Chapter XI, proceedings, dated January 6, 1948, seeking leave to compromise claims made by Wil-Rud Corporation, and after duly noticing same, in writing, to all creditors as required by law, a hearing was held before the undersigned Referee, in his courtroom located on the 3rd floor of the Federal Building, Los Angeles, California, on January 29, 1948, at the hour of 10 a.m.; at said hearing E. A. Lynch, the Receiver, was present and represented by Martin Gendel, of counsel, and the purchaser, Wil-Rud Corporation was present, and represented by its counsel, Chas. J. Katz, and the various creditors and their representatives were present, particularly those creditors represented by attorneys Frank T. Cotter, Hugh Ward Lutz, Aaron Levinson and Hugo Steinmeyer; after evidence, both oral and documentary, was duly introduced, and the objections of various creditors and the recommendations of the Receiver were considered, and after the arguments of counsel were duly submitted, and good cause appearing therefor, the undersigned Referee does hereby make the following Findings of Fact, Conclusions of Law and Order:

FINDINGS OF FACT

1. The undersigned Referee finds that the allegations contained in paragraphs I and II of the petition of E. A. Lynch, above referred to and dated January 6, 1948, for leave to compromise problems involved in the Wil-Rud Corporation sale, are true.

2. The undersigned Referee further finds that the Wil-Rud Corporation could reasonably contend that it was entitled to total adjustments in the sum of approximately \$28,000.00, and without passing further on the merits of said claims at this time, the undersigned Referee finds it would be for the best interests of the within estate to permit the compromise and settlement of the pending litigation and further claims on the basis of allowing a reduction of the purchase price in the sum of \$18,500.00, thereby reducing the purchase price to the sum of \$142,500.00, leaving a present balance due and payable, upon the signing of this Order in the sum of \$17,500.00; the purchaser, Wil-Rud Corporation having heretofore paid to the Receiver, E. A. Lynch, the sum of \$125,000.00 on account of the purchase price. It further appears that some of the creditors now objecting to the compromise submitted and approved a bid of \$135,000.00 to this Court on October 15, 1947, and requested this Court not to accept any higher bid; the undersigned Referee further finds that on November 7, 1947, this Court considered some of the claims of Wil-Rud Corporation concerning alleged shortages, and in-

licated from the Bench that it appeared that the said purchaser had relied on the inventory prepared in this estate, and, therefore, was entitled to pro-rata credits for alleged shortages in that inventory.

3. The undersigned Referee further finds that as a part of the compromise and settlement, the purchaser, Wil-Rud Corporation, is to hold E. A. Lynch, as Receiver of this estate, harmless for any refunds on cases and/or bottles up to 60c per wooden case containing 24 bottles, and each case and/or bottle surrendered up to Wil-Rud Corporation.

4. The undersigned Referee further finds that upon the payment of the sum of \$17,500.00 to the within estate, all claims by Wil-Rud Corporation, of any nature against the within estate, or E. A. Lynch, as Receiver, arising from the sale of Wil-Rud Corporation will be deemed compromised and settled in full, and likewise, the claims of the Receiver on behalf of this estate as against the Wil-Rud Corporation will be deemed compromised and settled in full, save and except for the payment of \$17,500.00, and the agreement of Wil-Rud Corporation to hold the estate and E. A. Lynch, as Receiver, harmless from claims for refunds on cases and/or bottles surrendered to the corporation by the holders thereof.

5. The undersigned Referee does further find it would be an unwise expense upon the part of the within estate to attempt to direct the Receiver to quiet title to all of the many hundreds of retailers

with whom the debtor corporation has dealt in order to be able to surrender the wooden cases involved in the within settlement to Wil-Rud Corporation free and clear of any claims, and that it would be cheaper for the debtor corporation and the Receiver to complete the proposed compromise and settlement rather than to attempt to deliver approximately 25,000 cases free and clear of claims pursuant to the representations contained on page 88-a of the inventory described in paragraph II of the petition for leave to compromise.

6. The undersigned Referee further finds that it is not for the best interests of the within estate to approve the proposed sale of the accounts receivable in the sum of \$3,500.00 to Wil-Rud Corporation, and by separate order is disapproving said sale and does find that it should not be made any part of the within approved compromise and settlement.

Conclusions of Law

From the above Findings of Fact, the undersigned Referee concludes:

A. That it would be for the best interests of the within estate to approve the compromise and settlement as heretofore submitted, save and except for the sale of the accounts receivable to Wil-Rud Corporation; and

B. The undersigned Referee further concludes that the objections to the proposed compromise and

settlement are not well taken and should not be sustained.

Order

Now, Therefore, based upon the Findings of Fact and Conclusions of Law, it is hereby Ordered:

1. That the petition of E. A. Lynch to compromise and settle the claims involved in the sale to Wil-Rud Corporation entered on October 22, 1947, be and the same is hereby approved.

2. That Wil-Rud Corporation is ordered to pay to E. A. Lynch, as Receiver of the within estate, the sum of \$17,500.00.

3. That Wil-Rud Corporation is ordered to hold E. A. Lynch, as Receiver, and the within estate, harmless from any claims for refunds on cases and/or bottles, up to 60c per wooden case for each such case or bottles surrendered to Wil-Rud Corporation.

Dated this 26th day of February, 1948.

/s/ HUGH L. DICKSON,

Referee in Bankruptcy.

Approved As To Form and Contents:

/s/ CHARLES J. KATZ,

Attorney for Wil-Rud
Corporation.

Received Feb. 13, 1948.

[Title of District Court and Cause.]

PETITION FOR REVIEW OF REFEREE'S
ORDER DATED FEBRUARY 26, 1948, BY
JUDGE

To Hugh L. Dickson, Referee in Bankruptcy:

The petition of Aaron Levinson, Bank of America, National Trust & Savings Association, Leo Brill, F. W. Boltz, Corp., a California corporation, and Victor Kremer, respectfully presents:

I.

That each of them is a creditor of the above named Debtor and that the aggregate amount of their claims is in excess of \$200,000.00, and approximately one-half of the total unsecured claims of said Debtor.

II.

That each of them appeared before this Court on January 29, 1948, at the hearing on the petition of the Receiver herein seeking leave to compromise the claims being asserted by Wil-Rud Corporation.

III.

That the Receiver herein filed a petition dated January 6, 1948, entitled "Petition for Leave to Compromise re Wil-Rud Corporation Sale" wherein said Receiver prayed that said petition for leave to compromise be approved.

IV.

That on February 26, 1948, an order was entered

granting the prayer of said petition in the words and figures as follows:

“1. That the petition of E. A. Lynch to compromise and settle the claims involved in the sale to Wil-Rud Corporation entered on October 22, 1947, be and the same is hereby approved.

2. That Wil-Rud Corporation is ordered to pay to E. A. Lynch, as Receiver of the within estate, the sum of \$17,500.00.

3. That Wil-Rud Corporation is ordered to hold E. A. Lynch, as Receiver, and the within estate, harmless from any claims for refunds on cases and/or bottles, up to 60c per wooden case for each such case of bottles surrendered to Wil-Rud Corporation.”

V.

The said order is erroneous for the following reasons:

(a) That neither the Receiver herein nor the Referee gave to the creditors in the notice to creditors or otherwise any information as to what are the claims of said Wil-Rud Corporation, and how said Wil-Rud Corporation arrived at the amount of its claims; and what are the shortages claimed by said Corporation and how it arrived at the amounts of said shortages, and said Wil-Rud Corporation has never reduced its claims to writing or filed them in this proceeding.

(b) That nowhere in these proceedings or the notice to creditors does it appear what the shortages are or upon which Wil-Rud bases its conten-

tion that it is entitled to an "adjustment on inventory shortages in the sum of \$19,336.80."

(c) That any claim of Wil-Rud Corporation based on inventory shortages is without merit by reason of order of this Court confirming the sale to said Wil-Rud Corporation dated October 22, 1947, approved by said corporation, ordering the transfer to Wil-Rud Corporation of all right, title and interest of this estate of all machinery, etc., located at 3631 Union Pacific Avenue, Los Angeles, California, together with all other physical assets of the debtor corporation "wheresoever situated . . . as of October 15, 1947, at 5:00 o'clock P.M."

(d) That any claim of Wil-Rud Corporation based on an assertion that the Debtor's customers who deposited 60c with the Debtor have a lien to that extent on each wooden case in the customer's possession is without merit.

(e) That the claim of Wil-Rud Corporation based on such alleged lien of 60c on each outstanding wooden case is as to the total amount of such claim merely a guess and the conjecture of said corporation; that nowhere does the number of such claims nor the amount thereof appear, nor does it appear any customer has asserted such a claim.

(f) That it does not appear from the record herein how the Receiver arrived at the amount of \$18,500.00 which he desires to allow said Wil-Rud Corporation.

(g) That there was no substantial evidence in-

troduced at the hearing on the petition to compromise upon which either the Court or the creditors could determine the merits or demerits of the petition to compromise.

(h) That the merits of the claims of said Wil-Rud Corporation should have been determined before the order approving the compromise was made.

(i) That no substantial evidence was offered upon which an order could be based that the approval of the proposed compromise was to the best interests of the creditors.

Wherefore, your petitioners pray for a review of the said order by the judge, and that the said order be vacated and set aside.

Dated: March 4th, 1948.

/s/ AARON LEVINSON,

In Pro Per.

BANK OF AMERICA NATIONAL TRUST &
SAVINGS ASSOCIATION,

By /s/ E. M. BERRY,

Its Attorney.

LEO BRILL,

By /s/ MAURICE M. GOODSTEIN,

His Attorney.

F. W. BOLTZ CORP., a California Corporation,

By /s/ FRANK T. COTTER,

Its Attorney.

VICTOR KREMER,

By /s/ HUGH WARD LUTZ,

His Attorney.

[Endorsed]: Filed Mar. 8, 1948.

[Title of District Court and Cause.]

REFEREE'S CERTIFICATE ON REVIEW

To the Honorable Ben Harrison, Judge of the
United States District Court, for the Southern
District of California, Central Division:

I, Hugh L. Dickson, Referee in Bankruptcy, to
whom the above entitled matter has been referred,
do hereby certify as follows:

That E. A. Lynch was duly appointed and qualified as receiver in the within Chapter XI reorganization proceedings, and pursuant to said order of appointment he took possession and continued the operations of the business being conducted by the debtor prior to the filing of the petition for the plan of arrangement, consisting primarily of the bottling of root beer and the sale of root beer extract; the major portion of the physical assets involved were located at the main bottling plant, 3631 Union Pacific Avenue, Los Angeles, California; that in the administration of the within estate it became advisable for the receiver to attempt to sell the assets of the estate; after due notice to creditors, hearings were held before this Court on September 25, October 7 and October 15, 1947.

On the 15th day of October, 1947, Mr. Aaron Levinson, on behalf of Mr. C. Ray Miller, read to the Court an offer of \$135,000.00 for the assets of the debtor corporation and requested the Court to accept this offer and not to permit competitive bid-

ding for the assets; that said attorney purported to submit the said offer, and the request that the offer be approved, on behalf of all of the members of the Committee of Creditors; that included upon said Committee of Creditors are the following creditors, now petitioning this Court for the review of the order in question:

Aaron Levinson.

Bank of America National Trust and Savings Association.

F. W. Boltz Corporation.

After your Referee opened the matter for competitive bidding, Wil-Rud Corporation, nominee of Samuel Rudolph, was adjudged the highest and best bidder, having offered \$161,000.00 cash for the assets.

That on October 22, 1947, this Referee signed an order confirming and approving sale of the assets to Wil-Rud Corporation; that pursuant to said order possession of the assets was turned over to the purchaser, Wil-Rud Corporation, and, thereafter, a dispute developed between E. A. Lynch, as receiver, and the said purchaser; that pursuant to a verified petition by said receiver an order to show cause was duly issued and served upon Wil-Rud Corporation directing said corporation to appear before this Referee on November 7, 1947, to show cause why the balance of the purchase price should not be forthwith paid; that at that time Wil-Rud Corporation had paid \$100,000.00 toward the pur-

chase price and there remained due and owing \$61,000.00; the Committee of Creditors had been duly informed of the order to show cause and there were present at the hearing Aaron Levinson and C. Ray Miller; from the evidence presented it appeared to this Referee that Wil-Rud Corporation had submitted its bid in reliance upon the inventory admittedly shown to Samuel Rudolph, its representative; that at said hearing held on November 7, 1947, Exhibit #1 was introduced, reflecting claimed inventory shortages totalling a gross amount of \$18,952.16; that Exhibit #2 introduced at said hearing is the inventory itself, allegedly relied upon by the purchaser in making its bid; that at said hearing this Referee indicated that he would rule that the purchase was made pursuant to the inventory, and that a pro-rate allowance would be made to the bidder on the basis of the total value of the inventory as against the inventory shortages, which would mean a reduction of approximately 40% of \$18,952.16; that at the said hearing on November 7, 1947, there was brought to the attention of this Court the fact that the purchaser was likewise contending for an adjustment involving wooden cases and bottles used by the debtor in the sale and delivery of its root beer product.

Thereafter a petition was filed by the receiver herein to compromise the claims of Wil-Rud Corporation centering upon two problems:

1. The inventory shortages covered in the hear-

ing above described, held on November 7, 1947, involving 40% of items totalling \$18,952.16; and,

2. A contention by the purchaser that the items contained on page 88(a) of the above referred to inventory could not be delivered free and clear to the purchaser for the reason that retail distributors had possession of the wooden cases and bottles involved and had paid 60c per case as a deposit thereon, and, therefore had a lien for said amount of 60c per case predicated on their possession of the cases; that the gross amount involved in the value of the cases and bottles referred to was \$47,976.29 (if this gross figure were recognized then 40% thereof would be the prorated deduction allowable to the purchaser); on the other hand, 25807 wooden cases were involved, and if the estate were required to pay 60c per case in order to clear any claim of lien as against the cases (described on page 88(a) of the inventory as "wood shells"), the total amount involved would be \$15,484.20.

That after due written notice to all creditors and interested parties a hearing was held upon the petition of the receiver to compromise the said two specific claims, and any and all other claims which Wil-Rud Corporation might have as against the within estate, on the basis that an \$18,500.00 reduction would be allowed in the total purchase price, making the net amount payable to the estate \$142,500.00, and, \$25,000.00 having been paid in addition to the original payment of \$100,000.00, the balance then due and owing would be the sum of \$17,500.00;

in addition thereto, Wil-Rud Corporation agreed to hold the receiver harmless from any claims for refunds arising from any attempts to return wooden cases by distributors with whom the receiver had dealt during his operation of the assets of this estate; that the hearing on said petition for leave to compromise was held before this court on January 29, 1948; that included at said hearing was a petition to sell outstanding accounts receivable to Wil-Rud Corporation, but, after a consideration of the facts involved at the time of said hearing, this Referee denied the petition to sell and directed the receiver to make his own collections thereon.

That on the 29th day of January, 1948, this Referee took the testimony of certain witnesses, to-wit, Ralph J. Yates, the accountant employed by E. A. Lynch as receiver, and, the testimony of Wolf Wilder and Samuel Rudolph as agents of the purchaser Wil-Rud Corporation; after considering the facts and arguments as submitted by counsel for the receiver, and the purchaser, and after considering the objections of various creditors, primarily those represented by the petitioners now on review, this Referee determined that it would be for the best interests of the within estate to approve the petition for leave to compromise.

This Referee was convinced that the purchaser had relied upon the written inventory handed to its agents in preparation for bidding upon the assets, as hereinabove recited in connection with the hearing held on November 7, 1947; this Referee further

was convinced that the physical assets owned by the corporation were sold free and clear to the purchaser, and there was a strong possibility that the receiver could not deliver clear title to the wooden cases and bottles involved without compensating the distributors to the extent of at least 60c per wooden case, since the distributors had possession of the cases and appeared to be entitled to claim a lien thereon until the 60c deposit had been returned; in addition thereto there was involved the practical problem of quieting title to many thousands of wooden cases located in the hands of several thousand vendees; under all of the circumstances, considering the legal and equitable problems involved, including the possibility of an adverse ruling on both items as against the receiver in the event of contested litigation with the purchaser, and the expense of such litigation, this Referee ordered the proposed compromise with Wil-Rud Corporation approved, and executed findings of fact, conclusions of law, and an order thereon, dated February 26, 1948.

That no order was sought or obtained by the present petitioners for review authorizing the filing of a petition for review of the order of this Court, although they were not parties to the petition to compromise the differences between the receiver herein and Wil-Rud Corporation, the purchaser.

This Referee proceeded pursuant to Section 27 of the Bankruptcy Act (U.S. Code, Title XI, Chapter 4, Section 50) governing compromises and reading as follows:

“The receiver or trustee may, with the approval of the Court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interests of the estate.” The procedure adopted by the receiver appeared to be in compliance with the General Orders governing bankruptcy proceedings, particularly Numbers 28 and 33; the sole question which this Referee believes is presented on the petition for review is whether or not this Referee abused his discretion in determining that approval of the petition for leave to compromise was for the best interests of this estate.

In compliance with the provisions of Section 39-a (8), I attach to this certificate the following:

1. The Reporter's Transcript Of Proceedings held on October 15, 1947, in re hearing on plan for sale of property;
2. The Order Confirming and Approving Sale Of Property To Wil-Rud Corporation, dated October 22, 1947;
3. The Petition Of E. A. Lynch As Receiver For Order To Show Cause, directed against Wil-Rud Corporation for the payment of the balance of the purchase price of \$161,000.00;
4. The Order To Show Cause against Wil-Rud Corporation issued by this Court on October 31, 1947;
5. The Reporter's Transcript of the hearing held on November 7, 1947, on the aforesaid order to show cause;

6. Petitioner's Exhibit No. 1, containing an itemization of alleged inventory shortages (introduced in evidence on November 7, 1947);

7. Petitioner's Exhibit No. 2, being the written inventory of the assets of the debtor (introduced in evidence on November 7, 1947);

8. Petition Of E. A. Lynch As Receiver, dated January 6, 1948, for leave to compromise claims of Wil-Rud Corporation;

9. Notice Of Hearing On Petition To Compromise, dated January 14, 1948;

10. Reporter's Transcript of hearing held on January 29, 1948, re petition to compromise;

11. Findings Of Fact, Conclusions Of Law and Order, dated February 26, 1948, approving petition for leave to compromise the Wil-Rud Corporation sale.

12. Petition dated March 4, 1948, For Review Of The Referee's Order, dated February 26, 1948, filed by various creditors.

Dated this 24th day of March, 1948.

Respectfully submitted,

/s/ HUGH L. DICKSON,

Referee in Bankruptcy.

[Endorsed]: Filed April 13, 1948.

At a stated term, to wit: The September Term. A. D. 1948, of the District Court of the United States of America, within and for the Central

Division of the Southern District of California, held at the Court Room thereof, in the City of Los Angeles on Thursday the 16th day of December in the year of our Lord one thousand nine hundred and forty-eight.

Present: The Honorable: Ben Harrison,
District Judge.

[Title of Cause.]

Memorandum Opinion reversing the order of the Referee on the Petition for Review of Aaron Levinson, Bank of America, Leo Brill, F. W. Boltz Corp., and Victor Kremer is signed and ordered filed in the above-entitled proceedings. Filed Memorandum of Opinion.

[Title of District Court and Cause.]

MEMORANDUM OPINION

This is a petition to review an order approving a compromise that had the effect of reducing the sale price of the assets of the corporation from \$161,000.00 to \$142,000.00.

The review is sought by creditors holding over one-half of the unsecured claims. The question involved is whether or not the Referee had the power to approve the compromise under the circumstances of this case.

The debtor was a functioning corporation engaged in bottling and selling root beer. Its assets were sold

at auction free and clear of liens to the highest bidder, the Wil-Rud Corporation, and the sale was duly confirmed. The business was then turned over to the buyer which paid part of the price. The balance was not paid, and an order to show cause why this amount should not be paid was issued. At the hearing the buyer offered the defenses that it had submitted its bid on the basis of an inventory shown to its agent; that a check made after possession was taken showed inventory shortages totaling a large sum, and that certain cases of bottles owned by the debtor were being held by distributors subject to a sixty cents deposit made on each case, which was not reflected in the inventory. The buyer thus claimed that it should not be held liable for the full amount of the bid but should be allowed a reduction.

The Receiver filed a petition to compromise this claim, and over objections at the hearing, the Referee ordered its approval in accordance with §27 of the Bankruptcy Act (Title XI USCA, §50). As a consequence the price arrived at was \$142,000.00 rather than the \$161,000.00 bid.

It is well settled that the rule of caveat emptor does apply to bankruptcy sales, and after discovery of a defect covered by this rule, a purchaser cannot refuse payment of the purchase price or claim abatement. (4 Collier on Bankruptcy 1588; *John Schaap & Sons Drug Co. v. Rone*, 19 F. (2d) 517, (C.C.A. 8th Circ.); *Hall v. McGehee*, 37 F. (2d) 854, (C.C.A. 5th Circ.); *Handlan v. Bennett*, 51 F. (2d) 21, (C.C.A. 4th Circ.). However, as stated in 4 Collier on Bankruptcy 1588:

“The rights and quantum of property acquired by the purchaser depend primarily upon the terms of sale as ordered or agreed upon. In the absence of specific warranty clauses the bankruptcy sale is governed by the rule ‘caveat emptor.’ ”

At the auction it was understood that a going business was the subject of sale, and it was expressly announced that the sale was “as is.” As the purchaser made no objection before confirmation, it must then be held to have taken the property subject to that condition. (*Handlan v. Bennett*, 51 F. (2d) 21, (C.C.A. 4th Circ. 1931); *In Re Rapier Sugar Feed Co.*, 13 F. Supp. 85 (1935).

In the Order of Confirmation the sale was stated to be of all machinery, fixtures, equipment, all inventory, all furnishings, all supplies, etc., located at a certain address, together with all other physical assets wheresoever situated, “as of October 15, 1947, at 5:00 o’clock P.M.;”.

The purchaser claims that it based its bid on an inventory of the business made July 28, 1947, and shown to its agent about ten days before the bidding, October 15, 1947. After it took over, certain items were not found to be present as per the inventory. This was one of the bases for the refusal to pay.

The sale was not represented to be offered or made of all assets reflected in this inventory, nor was the bid stated to be offered on that basis at the sale. In fact, the bid was expressed to be offered on the same basis as that of a competing bidder, who bid \$160,000.00, only \$1,000.00 less than the suc-

cessful bidder. There was no mention of any inventory in this competing bidder's offer, but it was stated to be "for all of the outstanding shares of Yankee Doodle Root Beer Company," which was a wholly owned subsidiary, "and for the physical assets of California Associated Products, * * *."

This was an operating business. The language clearly shows that the sale was of all such assets on hand at that time, and not of assets which may have been on hand two months previous. Under these circumstances the buyer was not justified in failing to complete the sale in this manner by a refusal to pay. The conditions of the sale preclude any such arguments.

The case of *In Re Solantkias*, 33 F. (2d) 200, (D.C.W.D.Pa. 1929) offered a very similar situation. There also the purchaser sought to withhold part of the purchase money, claiming that the goods did not in fact conform to the inventory submitted by the Receiver to the bidders at the public sale. The court stated as follows:

"We concur in the views expressed by the referee that Diamond had no right to withhold the payment of the \$3,500 on account of alleged discrepancies between the inventory and the goods actually turned over by the receiver Diamond. This was a judicial sale to which the rule of caveat emptor clearly applied. If a fraud be practiced upon the purchaser at a public sale, he should immediately ask to have the sale set aside and return the property. The court could then give him the relief to which he is

entitled. He could not adjust that matter himself by withholding a part of the purchase money.”

See also *In re Bender Body Co.*, 139 F. (2d) 128, (C.C.A. 6th Circ., 1943; *Hall v. McGehee*, *supra*).

There is, however, another ground on which this order should be reversed. The validity of a bankruptcy sale is not open to inquiry or impeachment in any collateral proceeding in either a state or federal court. (*Slocum v. Edwards*, 168 F. (2d) 627, (C.C.A. 2nd Circ. 1948); 4 *Collier on Bankruptcy*, 14th ed. p. 1587, 1588; *Tuck v. Patterson*, 29 A.B.R. (N.S.) 88, 60 S.W. (2d) 328). The proper method for questioning the sale is by a petition to review the order of confirmation, which would have to be filed within the allowed period, (§39, sub. (c) Bankruptcy Act, 11 USCA §67, sub. (c); *In Re Bender Body Co.*, *supra*), or by a petition to vacate or set aside the sale. (*In Re Solantkias*, *supra*; *In the Matter of Union Co-op. Bakery*, 4 F. (2) 535, (C.C.A. 6th Circ. 1925); 4 *Collier on Bankruptcy* 1581; *Staley v. Dwyer*, 29 F. (2d) 982). If the purchaser desired relief from an onerous sale these were the methods it should have used. It should not be entitled to keep the benefits of the sale as a successful bidder, and, at the same time, get a reduction in the price merely by its refusal to pay the purchase price. This would seriously prejudice the rights of other bidders and creditors or the debtor, and might act as a fraud on them. This would particularly be so here in view of the fact that the unsuccessful bidder bid only \$1,000.00 less than the sale

price. In the administration of bankrupt estates with the many complicated problems that arise therein, irregularities often occur. It is important that the confidence in the stability of judicial sales be not destroyed. (*Scott v. Jones*, 118 F. (2d) 30, 32, (C.C.A. 10th Circ. 1941); *In Re McCann*, 250 F. 1006, (D.C.N.D., N.Y.); *In Re Strunks Lane & Sellico Mountain Coal & Coke Co.*, 64 F. Supp. 731 (D.C.E.D. Ky. 1946); *In Re Wolke Lead Batteries Co.*, 294 F. 509, (C.C.A. 6th Circ. 1923). To induce bidding at such sales and reliance upon them, the purpose of the law is that they shall be final. *Currin v. Nourse*, 66 F. (2d) 137, (C.C.A. 8th Circ. 1933); *Pewabic Mining Co. v. Mason*, 145 U.S. 349, 356, 12 S. Ct. 887. A good discussion of the consequences of such action as here presented is found in *In Re Bender Body Co.*, 47 F. Supp. 224; affirmed in 139 F. (2) 128.

Against this argument the buyer claims that the power to approve a controversy is one of the broadest powers conferred by the Bankruptcy Act, and once a Referee approves such a controversy, his action should be set aside only for a distinct abuse of discretion. (2 *Remington on Bankruptcy* 720, 721; *In re Stuart*, 272 F. 938 (C.C.A. Ohio); *In re Paley*, 26 F. Supp. 952; *Scott V. Jones*, 118 F. (2d) 30). Weighing both of these, it is clear that the power to compromise if applied as here can undermine any stability in judicial sales and open wide the gate for the re-examination of public sales in bankruptcy.

In this matter the equities are not with the purchaser. The approval places a direct loss upon the creditors as the next bidder had offered \$160,000.00. If the compromise should stand the creditors will suffer a loss of \$18,000.00. If the purchaser had acted in good faith, he would have rescinded the sale and if approved by the Referee a new sale could have been held, and the creditors would have been protected. As it now stands the purchaser desires to retain the advantages of his bargain together with the refund sought through compromise. The purchaser purchased the assets of this corporation at a public auction knowing full well what he was buying and I see no reason why he should not be held to his bargain.

In view of the fact that the petition to compromise, filed after the confirmation of the sale was a collateral attack on the sale, and considering the consequences of such action if permitted, the order of the Referee in approving the compromise is hereby reversed.

Dated: This 16th day of December, 1948.

/s/ BEN HARRISON,
Judge.

[Endorsed]: Filed Dec. 16, 1948.

[Title of District Court and Cause.]

FINDINGS OF FACT, CONCLUSIONS OF
LAW AND ORDER GRANTING PETITION
FOR REVIEW AND REVERSING ORDER
OF REFEREE APPROVING COMPROMISE

This matter coming on before the undersigned upon a Petition for Review filed by certain creditors to review an Order made by Hugh L. Dickson, one of the Referees in Bankruptcy of this Court on the 26th day of February, 1948. The petitioners on review herein being the following, to-wit: Bank of America National Trust & Savings Association, a creditor represented by its attorney John Walters, Leo Brill, a creditor represented by his attorney Maurice M. Goodstein, F. W. Boltz Corporation, a creditor represented by its attorney Frank T. Cotter, Victor Kramer, a creditor represented by his attorney Hugh Ward Lutz and Aaron Levinson, a creditor represented by himself. E. A. Lynch, the receiver and trustee appeared and filed a brief herein and was represented by Craig, Weller & Laugharn by Hubert F. Laugharn, his attorneys. Permission was granted to the Wil-Rud Corporation through its attorney, Charles J. Katz, to appear and file a brief herein.

The Court made and filed herein its Memorandum Opinion dated December 16, 1948, and adopts herein the findings therein contained and in addition thereto,

Now, Therefore, the Court makes the following Findings of Fact, Conclusions of Law and Order reversing the Order of the Referee of February 26, 1948, which approved the Petition to Compromise a certain controversy with the Wil-Rud Corporation. The Court cannot adopt the Findings of the Referee in this matter and therefore finds:

1. That E. A. Lynch was the duly qualified and acting receiver in the within proceedings and conducted the going business of the bankrupt from his appointment on July 29, 1947, as receiver, to and including October 15, 1947. That on October 15, 1947, he brought on for sale in open court before the Referee certain assets of the debtor corporation. At such time there was competitive bidding. A bidder offered \$160,000 and thereupon a bid of \$161,000 was made on the same terms by the Wil-Rud Corporation "for all of the outstanding shares of Yankee Doodle Root Beer Company and for the physical assets of California Associated Products * * *". Thereupon said bid and offer of Wil-Rud Corporation was accepted by the Court and the receiver, and the sale was confirmed by an order of the Referee, and the Wil-Rud Corporation paid \$125,000 on said purchase price of \$161,000.

2. That the business and assets had been in the possession of the receiver for some period of time and he had been carrying on the business of the bankrupt corporation. That his inventory of the assets was made at the inception of the proceedings,

to wit: as of the close of business on July 28, 1947, and was not corrected or adjusted from day to day. That said inventory does not purport to be other than an inventory made as of July 28, 1947. That this fact was made known to all bidders. That at the time of the sale the said assets were offered "as is" and without any warranty as to quantity or quality and without any reference to an inventory. That immediately after the confirmation of the sale, the assets so sold were delivered to the Wil-Rud Corporation. That thereafter the Referee's order approving and confirming the sale was approved in writing by the Wil-Rud Corporation and signed by the Referee on October 22, 1947. That thereafter a controversy arose between the purchaser and receiver as shown in paragraph II(a) and (b) of the receiver's Petition for Leave to Compromise re Wil-Rud Corporation sale.

3. That thereafter the receiver petitioned said Referee for authority to compromise said controversy. Ten days notice of the receiver's petition was given to all creditors and upon the hearing the petitioners on review herein, who are creditors in the within proceeding and who represent over one-half in amount of the unsecured claims approved herein, appeared and objected to the confirmation of the said compromise. That the record does not show that any creditors were in favor of said compromise.

4. That said sale was not made on the basis of a sale of the assets as reflected in the receiver's

inventory as of the close of business on July 28, 1947, nor was the bid of Wil-Rud so made.

5. That the said Wil-Rud Corporation was not warranted in relying upon nor did it rely upon the inventory in making said bid. That it was not in the best interests of creditors that the said proposed compromise be ordered.

6. That no review was taken at any time by Wil-Rud Corporation from the Order of Sale to it and that the same is final; and that said Wil-Rud Corporation has taken no steps to set aside such sale or return the property delivered to it by the Receiver.

The Court concludes as a matter of law that:

1. The Order of October 22, 1947, confirming the sale of the assets of this estate to Wil-Rud Corporation for the amount of \$161,000 is final and that no review has been taken therefrom.

2. That the within proceedings cannot be maintained as a collateral attack upon the Referee's order of sale dated October 22, 1947.

3. That the equities herein are not with the purchaser in that there was a bid of \$160,000 which was rejected because said Wil-Rud Corporation increased said bid by \$1,000; that said bid of \$160,000 was for the assets as they then existed and not with the qualifications or restrictions now insisted upon by said Wil-Rud Corporation. That the credi-

tors of this bankrupt will suffer a loss of \$18,500 if the order of compromise is finally approved.

4. That said Wil-Rud Corporation did not disaffirm the sale but took possession of the assets and cannot in this manner attack the sale; and said Wil-Rud Corporation is bound by the rule of caveat emptor.

5. That there is no evidence that anyone has ever claimed a lien against the property purchased by said Wil-Rud Corporation from the receiver, other than the conditional sales contract holder specifically mentioned in the order confirming the sale to Wil-Rud Corporation.

Therefore, for the reasons as set forth herein, the Order of the Referee dated February 26, 1948, affirming the Receiver's compromise whereby he credited to the Wil-Rud Corporation the amount of \$18,500 upon its purchase price of \$161,000 should be and the same hereby is reversed and set aside, and said petition to compromise denied.

Dated: May 24, 1949.

/s/ BEN HARRISON,

U. S. District Judge.

Judgment entered and Docketed May 26, 1949.

[Endorsed]: Filed May 24, 1949.

[Title of District Court and Cause.]

NOTICE OF APPEAL

To the Petitioners for Review, Bank of America National Trust and Savings Association, Leo Brill, F. W. Boltz Corporation, a California Corporation; Victor Kramer, and Aaron Levinson, and to Their Respective Counsel of Record, and to E. A. Lynch, Receiver and Trustee in the Above-Entitled Matter, and to His Counsel of Record:

Notice Is Hereby Given that Wil-Rud Corporation, a party aggrieved by the Order granting Petition for Review and reversing Order of Referee Approving Compromise, heretofore made and entered on May 26, 1949, in Judgment Book 58, page 475, of the above-entitled court, hereby appeals to the United States Circuit Court of Appeals for the Ninth Circuit, from that certain Order granting Petition for Review and reversing Order of Referee Approving Compromise heretofore made and entered on May 26, 1949, in Judgment Book 58, page 475, in the office of the Clerk of the above-entitled court, whereby the Order dated February 26, 1948, of the Referee was reversed upon the Petition for Review of Aaron Levinson, Bank of America, Leo Brill, F. W. Boltz Corporation, and Victor Kramer.

Dated this 20th day of June, 1949.

/s/ CHARLES J. KATZ,

Attorney for Appellant,
Wil-Rud Corporation.

[Endorsed]: Filed June 21, 1949.

In the District Court of the United States, Southern District of California, Central Division

No. 45,137—BH

In the Matter of

CALIFORNIA ASSOCIATED PRODUCTS,
Debtor.

Before: Hon. Hugh L. Dickson,
Referee.

REPORTER'S TRANSCRIPT OF PROCEEDINGS
IN RE HEARING ON PLAN FOR
SALE OF PROPERTY

Appearances:

EDWARD LYNCH,
Receiver.

MARTIN GENDEL, ESQ.,
For the Receiver.

CHARLES J. KATZ,
For Samuel C. Rudolph.

AARON LEVINSON,
For Mr. Miller.

FRANCIS F. QUITTNER,
For Preferred Stockholders.

HUGO A. STEINMEYER, ESQ.,
For the Bank of America. [1*]

Wednesday, October 15, 1947

The Referee: What is the plan?

* Page numbering appearing at top of page of original Reporter's Transcript.

Mr. Levinson: Your Honor, at the outset, I would like to state that I am not here representing any purchaser or any creditor other than myself—and I think a small creditor in the amount of \$25. What I have to say is not as an attorney for any one.

After the last meeting here, it was the thought of two of the other attorneys who represent large creditors and myself that a meeting should be held in an endeavor to straighten out some of the confusion which existed here last week and so that something concrete can be presented to you. Accordingly, on Friday afternoon the representatives of the largest creditors met, representing over \$200,000 unsecured claims; and we met again yesterday afternoon.

Now, it was the consensus of opinion of those creditors that we should consult with all parties interested in an endeavor to obtain the best bid from those parties and from any one that we could interest and submit it to the Court. We were advised before we met yesterday afternoon by Mr. Katz who represents Mr. Rudolph, that regardless of any bid which the group might present to the Court, that it was his intention to ask the Court to open the matter to bidding; that is, I assume—while Mr. Katz didn't say it—if we didn't agree to recommend his bid, the bid that he offered on behalf of Mr. Rudolph. The creditors who were present said they represent over \$200,000 worth of unsecured claims and they have given consideration to

the plight of the franchise holders; and both offers of Mr. Rudolph and the other offer contemplate that the business would be continued. Each offer contemplated—and by the way, we have to eliminate Mr. Weiser's offer because his offer, while in writing, is much lower than that of either of the bids which were submitted to us. It was the consensus of those present that we would recommend to the Court that the Court direct the Receiver to make an immediate sale to the bid which was accepted by the Court. I have the bid here with a check accompanying it, the one which the creditors decided to recommend to the Court, and I will read it for the benefit of all those who are interested. It is directed to Mr. Lynch, the Receiver.

“The undersigned proposes to pay for all of the outstanding shares of Yankee Doodle Root Beer Company”——

and that, by the way, is a wholly-owned subsidiary, I understand, and its franchises for the assets of the Yankee Doodle Root Beer Bottling Company—that is merely a trade style, which is owned by the debtor——

“and for the physical assets of California Associated [3] Products, subject to the following exceptions, the sum of \$135,000. In addition to the foregoing, we are to receive all trade names, trademarks, all formulas, and registered trade styles, and the lessee's interest in the lease,”——

and I might say, your Honor, with regard to the lessee's interest in the lease, that it is understood that the purchaser will be able to obtain the consent of the landlord to the purchaser continuing the business. I have talked with the landlord in person and the landlord assured me that if the purchaser was a responsible person, a responsible corporation, that they would consent to the transfer of the lease to the purchaser. However, that contingency exists with any purchaser and all of the purchasers are assured that they will get the consent of the landlord for the lease.

The offer goes on:

“We are not to receive any of the merchandise held by the Bank of America as security for its pledge or any items held at Fresno to secure two pledges of firms located there. Nor are we to receive the cash on hand, accounts or notes receivable, or deposits made by those corporations. We will take over the existing insurance on a pro rata basis. Title to all property delivered to us is to be free and clear except the water softener.” [4]

And, I might say that Mr. Katz informed my office that there is a balance due on the water softener of \$1,699.17; so the offer is \$136,699.17.

“A check for \$10,000 is tendered herewith as evidence of good faith. Confirmation of the sale is to take place on or about October 20, 1947.

Yours very truly,”

Signed by Mr. Miller.

Now, it is the unanimous opinion of the cred-

itors who were present at this meeting—and they represent over \$200,000 in the amount of claims—that this offer should be accepted and the Receiver should be directed to sell.

Mr. Katz: I stated to the creditors' committee, and I state in open court that as a matter of sound public policy and the proper administration of the Bankruptcy Act that I do not believe that it would be wise to follow the practice which Mr. Levinson laid out to me which was this——

The Referee: I am going to sell it to the highest bidder for the greatest amount of money in the interest of all creditors. I cannot say that I am bound or interested in the interests of any creditors' committee. Whatever we sell here will be sold to the man who is willing to give the greatest amount of money for it. You needn't talk to me about that.

Mr. Gendel: May I clarify one problem that we have here: Apparently, in the subsidiary company of Yankee Doodle [5] Root Beer, the corporation, there is held an asset consisting of the promissory note reflecting an unpaid balance from Loma Linda that is an Adventist institution in the Southern part of our state. The unpaid balance is approximately \$4300 and I would like the bidders to keep in mind that although we would be selling all of the stock of the Yankee Doodle Root Beer Company, nevertheless, it is the intent of the Receiver, unless the bid is decreased by a comparable amount, to retain the promissory note and the accounts receivable of \$4300. Mr. Levinson's offer pointed out that

there is a problem of proration on insurance, for the reason that the proration of insurance will net the estate approximately \$3,000. So, we want the reservation of that proration kept in mind. The last item that we would like to retain, unless the bid is increased by a comparable amount, would be such rights as belong to the estate arising from the payment of life insurance by the debtor corporation on the lives of Thompson and Greene. We understand that there is a cash surrender value of approximately \$1500 and, therefore, we would like to reserve that for the estate. I thought it well to point out those problems to the prospective bidders, your Honor, so that there wouldn't be any confusion after the highest bid is accepted.

The Referee: Let me call your attention to this fact: Yesterday there was filed a petition in reclamation by the Western Crown Cork and Seal Corporation alleging that they [6] were the owners of 1—C.E.M. 40 V machine No. C & M-1 general mixer. They claim that that was sold on conditional sales contract. I don't know anything about it.

Mr. Levinson: We have that in mind. May I say something further in view of your Honor's remark with regard to accepting the highest bid. I think your Honor, in fairness to these gentlemen, Mr. Miller and his group, and also with respect to the creditors' committee which has worked so hard on this matter, that if your Honor is to open this matter up for bidding, that the first bid should be

a substantial increase over the bid which I have just read. I don't think that we ought to start with peanuts.

The Referee: Well, I will try to run this sale according to the best of my ability. After some twelve years of experience, I say to you that it is now my definite policy to get the greatest amount of money in every case. I don't care who pays it.

Mr. Katz: The Court read a petition in reclamation from the Western Crown Cork and Seal Corporation. Under your proposal, do you expect the amount of that indebtedness, if it is upheld, to be added to the amount of your bid?

Mr. Levinson: I don't have any bid.

Mr. Katz: I don't mean your bid. I will reserve my own opinion as to that. The bid you read, does that contemplate that the bidder takes the assets, subject to the claim of the Western Crown Cork and Seal Corporation, or do [7] the creditors, out of the cash of \$135,000 pay that balance?

Mr. Levinson: Let's be fair about this. You have indicated that it is my bidder. This is my bidder that you reserve your opinion as to whether it is my bidder or not. Let's be frank.

Mr. Katz: I have the constitutional right to form my opinion.

Mr. Levinson: I don't have to answer your question then.

Mr. Katz: May the Court ask the bidder whether his bid is free and clear of the Western Crown Cork and Seal, or whether it is to be paid out of

the amount that he is bidding. We want to be bidding on a par. That is my point.

The Referee: Well, Mr. Levinson has indicated disinclination to answer it. I don't know why there should be so much secrecy. Now, he has disclaimed any assumption that it was your bid. I join with him in that disclaiming. Now, I am asking you what he asked you, if you take it free and clear or do you intend to pay this claim if it is allowed?

Mr. Levinson: The bidder does not pay; the estate pays it if it is found to be a valid claim.

Mr. Lynch: That is in the sum of \$11,725.

The Referee: I thought it only fair to call your attention to that fact because it may or may not detract from the assets here; and in addition, Mr. Radkin asked for [8] a reasonable attorney's fee. That may be one thousand or two thousand dollars or four thousand dollars more. I have a very different idea of what he will get.

A Voice: I represent the Yankee Doodle Root Beer Bottling Company of San Fernando Valley and therefore have a status to speak, being a franchise holder. The thing that concerns us and which should be brought to the attention of the creditors is that a certain manufacturing company, selling coolers, a piece of equipment of some several thousand dollars sale price, are now making the claim that they sold such a piece of equipment to the Yankee Doodle Root Beer Company on a conditional sales contract, that being the same piece of equipment that company proceeded to sell to my clients

and for which my clients paid cash. Now, it is of course our position that we made a legitimate purchase and I understand the record of the Yankee Doodle Company show that the piece of equipment was shipped on open account. However, if there is going to be such a claim that it was sold on a conditional sales contract, there would be an additional claim by my clients against Yankee Doodle Root Beer Company, apart of the fact that I have recommended prosecution.

The Referee: You will have to see Mr. Simpson about that.

Mr. Katz: We are prepared to bid, Judge Dickson, on the same basis as I have just actually asked so we know [9] what we are talking about. If Mr. Levinson would indicate exactly whose bid it is, we intend to bid on the same basis as the bid that he labels so that we know what we are talking about.

The Referee: I understood him to mention a Mr. Miller. It was a creditors' committee bidder.

Mr. Katz: We are prepared to bid on the basis of that bid and bid higher.

The Voice: There is one more thing that must be brought to the attention of the Court. In connection with these bids, we want to know if they are assuming, or if there is any question that they are assuming the contractual obligations to the existing franchise holders, or if they are being totally disregarded.

The Referee: I can't answer that. I don't know.

Mr. Gendel: We are only selling our interests.

The Referee: I don't see how you can bind the purchaser.

The Voice: That may result in some considerable litigation.

The Referee: Don't threaten me with it.

What is the bid, Mr. Katz?

Mr. Katz: So there is no question, do I understand that the bidding now is on the basis of a sale by the Receiver pursuant to his equity power to sell the assets as distinguished from any plan? [10]

The Referee: That is the way I understand it.

Mr. Gendel: Mr. Katz, as I understand the situation, counsel for the debtor in and within the provisions has indicated to the Court that he has no plan to give to the Court. So, in preserving the assets, including the lease and the other items that might be called perishables, if delay ensues we feel that this Court has the power to approve a sale by the Receiver as part of the Chapter 11 proceedings and it is under that authority that we assume the Receiver will sell free and clear except as to those items that contain a sale of the right, title, and interest in the lease only.

Mr. Katz: We bid on the same basis as the Miller bid, \$137,500.

The Referee: \$137,500. Any other bids?

Mr. Miller: If your Honor please, I made the original bid. We presented our plan here in court and apparently our plan was not given considera-

tion at the last hearing. It was read, and there was nothing more said about it. We feel that we had the interest of both creditors and the equity holders in mind, and apparently the other bidders do not feel so. So, if your Honor please, we will up our bid to \$140,000.

Another Bidder: \$141,000.

Mr. Miller: \$145,000.

Another Bidder: \$146,000. [11]

Mr. Miller: \$150,000.

Mr. Katz: Would your Honor mind about a two minutes' recess?

The Referee: The court will take a ten minutes' recess.

(Recess.)

Mr. Gendel: The original bid as read said the lessee's interest in it. We will sell the right, title, and interest of the estate in and to the lease.

Mr. Katz: That isn't Mr. Miller's bid now.

Mr. Gendel: We only know the way that we can deliver to the buyer, what the Receiver represents he can deliver.

Mr. Adams: I represent Mr. Ward, one of the franchise holders, and I object to the sale proceeding until the terms of the sale are established so that the bidder and the claimants know where they stand with reference to the terms of that bid and possibly take it in before the Court and get a ruling.

The Referee: I don't quite understand what you are talking about.

Mr. Adams: I think the terms of the sale should be established before the property is offered for sale. I object to the sale proceeding until those terms are established, including the right of the franchise.

The Referee: I don't consider the franchise holders own any part of the assets of this estate. They have a contract with the debtor corporation for certain things, [12] but I don't see that they have any assets in the estate. However, you can make any objection you see fit.

Mr. Katz: As I understand it, Mr. Miller is bidding on the basis that the lease be put into good standing.

Mr. Miller: If your Honor please, I will change the wording; we will make this bid subject to our being able to obtain the lease from the landlord.

Mr. Gendel: You can't do that, Mr. Miller.

The Referee: You must realize that this Court has no control over the assets of that landlord. He might say "I don't like the color of your hair, or for any one of nine hundred good reasons, he might refuse to give you a lease. I can't sell it with that condition attached to it.

A Stockholder: On behalf of the controlling common stockholders, I would like to be heard briefly on the subject of this lease. I think this fact should be clearly understood by the bidders so that there can be no subsequent misunderstanding. The owners of that building have promised certain individuals and not these bidders that they will

have their first and prior right to receive a lease on the property.

Mr. Gendel: May I interrupt this gentleman for a moment. I don't know what the prupose of his speech is except to depreciate the assets that are being sold. I don't see how that can benefit the common stockholders or the estate as a whole. If that is the position the common stockholders hold, I think that counsel speaking has no stand in the court. He doesn't speak for the landlord. It is a rather unusual situation to discourage prospective bidders when an estate is supposed to benefit from the bidding.

The Referee: Who do you represent?

The Stockholder: I represent Mr. Greene and Mr. Thompson and certain other common stockholders. The purpose of these remarks was simply this: If there is to be any condition attached to this bid, if it is to be based in any way whatsoever upon the successful bidder procuring the piece, then this estate is going to be thrown into the utmost confusion and this sale here this afternoon will but serve to confuse this whole matter. We ask, if the Court please, that if there is to be a sale this afternoon that the phase pertaining to the lease be most clearly defined. Otherwise, the bidder at a subsequent time may raise a lot of problems that are not before the Court now.

The Referee: All right.

Mr. Katz: Mr. Rudolph bids \$146,000 on the same basis as the Miller bid excepting only that

with respect to the lease he will take whatever right, title, and interest in the estate that the estate can convey to him.

Mr. Gendel: That is the way to bid it.

The Referee: All right. \$146,000. Does any one want to bid over that? [14]

Mr. Miller: We would like a recess.

The Referee: Are you willing to give more than \$146,000? I am not going to have any more recesses. You are all grown-up men and you come here knowing fully what you are willing to pay. No use back fishing.

Mr. Miller: If your Honor please, we endeavored to discuss with the landlord today on this matter and unfortunately he is in the hospital. The owner of the property is in the hospital sick. I think we should have the same right to talk to him.

The Referee: I am not going to agree with you. I am going to settle this this afternoon. The question is, do you want to bid in excess of \$146,000 without any assurance that you will get a lease?

Mr. Quittner: I represent the preferred stockholders, if the Court please. I just want to interpose this statement. If any of these bidders know that they can get a lease, it is quite obvious——

Mr. Katz: We don't know anything of the kind.

Mr. Quittner: The original bid was \$150,000.

The Referee: Mr. Miller attached a condition on his bid of \$150,000.

Mr. Katz: I say to you categorically we have no assurance whatsoever.

Mr. Levinson: The deal between Mr. Rudolph and Mr. Thompson and Mr. Greene, as I understand it, is that as far [15] as the debtor corporation is concerned, that the debtor corporation will have a chance to repurchase these assets at a certain price if we purchase it within thirty days, and at another price if it is repurchased within sixty days, and at another price within ninety days.

Mr. Katz: That was the plan of settlement at \$125,000. This is a liquidation sale.

The Referee: What I want is bids; I don't want any more blocks thrown in the way of this sale.

Mr. Levinson: I am not throwing any blocks.

The Referee: I am asking for bids. I don't want any more tales of what happened two or three weeks ago. Does anybody want to bid more than \$146,000 for this property. Apparently there are two groups here that are trying to get a loggerhead. What I want is the most money. I am going to sell it pretty quickly now.

Mr. Miller: Will you please withdraw your ruling against a recess for a few minutes? I believe these parties who have come up here to bid should have a short opportunity for consideration.

The Referee: I understand you were in a huddle yesterday afternoon.

Mr. Levinson: They were not with us.

The Referee: Let me say this to you: If I should reverse my ruling and give you a ten min-

utes' recess, it will be with the understanding that your bid is without any [16] requirement that this Court or this Receiver deliver the lease to you. You can throw that out the window, because we can't do that and we can't promise that.

I will give you a ten minutes' recess.

(A short recess.)

The Referee: What is the bid now? The last bid was \$146,000, as I recall.

Mr. Steinmeyer: May I make a statement: I represent the Bank of America, which is an unsecured creditor. The Court may desire testimony as to the matter that I am about to address to the Court, but the information that has been given to me is that the difficulty with respect to the lease on this property and the possible assignment of the lease by the debtor corporation to the purchaser at the sale arises from the fact that Mr. Greene and Mr. Thompson, the officers of the debtor corporation, have heretofore approached the landlord and secured the representations of the landlord that he would give them a lease if the property was sold. Now, they represent the officers and the equity owners to a great extent of the debtor corporation. I think that if that action has been taken and if those statements are correct, that their conduct has been contrary to the best interests of the estate and that under those circumstances the Court should direct that if any such lease should be obtained, that it would become the asset of the Receiver of

this estate and not the officers [17] of the debtor corporation.

Mr. Katz: It is agreeable to us as a bidder.

Mr. Tobin: Mr. Steinmeyer is absolutely right on that.

Mr. Levinson: Mr. Thompson, Mr. Greene, and I can testify as to what our conversation was with the landlord with regard to that which has resulted in a stifling of bidding as far as one group here is concerned. I think that these two gentlemen are merely trustees for the benefit of the shareholders and the creditors, and I think that they should not have the right either directly or indirectly that this lease be given, or the consent be given, to any particular purchaser whom they may favor. That it should belong to the Receiver.

Mr. Katz: As one of the bidders, we haven't any objection to that position.

The Referee: All right, sir.

Mr. Lesser: I represent the majority of the preferred stockholders. Most of the money that went into this transaction originally came from the preferred stockholders. We believe that Chapter 11, as we understand it, provides that the Court should give consideration—we appreciate the fact that the prime consideration is to the creditors—but as preferred stockholders, if we may, we would like to interpose at this time to say that once this question of lease is straightened out, and it can only be straightened out through one of the gentlemen who is in the hospital and [18] a couple of

days, or maybe one day will do it, that the preferred stockholders are in a position here to add a sum of money over and above the bid to be added to the bid as set forth by Mr. Miller. It will be to the advantage of the creditors here, and the preferred stockholders will get a break in this particular situation to which they are entitled and we believe it is for the best interests of everybody concerned, as well as the franchise holders and the preferred stockholders.

The Referee: How long has this man been in the hospital?

Mr. Lesser: He is in the hospital for two days.

The Referee: Why didn't you go to see him in the hospital? I am not going to continue this. I am going to ask for the highest bidder this afternoon. Any other bids now? I gave you ten or fifteen minutes to huddle on this thing.

Mr. Steinmeyer: I think if the Court would make a ruling to any lease obtained by Thompson or Greene will be held in the trustees.

The Referee: That is right; or anybody deriving the benefit from it.

Now, what is your bid? I gave you fifteen minutes.

Mr. Miller: We bid \$150,000 on that condition.

Mr. Gendel: Just on behalf of the Receiver, on what condition? [19]

Mr. Miller: The condition just stated that it be made a part of any agreement that Thompson and Greene had with the landlord which would become

the property of the Receiver and as part of the assets of the debtor corporation; is that correct?

The Referee: That is right.

Mr. Gendel: You understand the Receiver is selling the title and interest to the lease only.

Mr. Miller: I am talking about what the Judge just ruled.

A Bidder: \$151,000.

Mr. Miller: We bid \$155,000.

The Bidder: \$156,000.

Mr. Miller: \$157,000.

The Bidder: \$158,000.

The Referee: \$158,000 once, twice,—

Mr. Miller: We bid \$160,000.

The Bidder: \$161,000.

The Referee: Sold for \$161,000 to the Wilrod Corporation.

Mr. Gendel: May I on behalf of the Receiver make a closing statement in connection with what I understand the Receiver wants to confirm as part of the sale so that there is no question.

The Receiver is selling to the buyer all of his right, title, and interest in and to the lease of the premises in [20] question occupied by the debtor corporation. The Receiver is likewise selling the Receiver's interest in stock certificate No. 6, representing three shares of Yankee Doodle Root Beer Company, a corporation, which we have been told are all of the issued shares of the subsidiary company. The Receiver is selling the machinery, equipment, and fixtures located at the place of business

of the California Associated Products Company, 3631 Union Pacific Avenue, and the inventory as is now subject only to the balance owing on the water softener of \$1699.17. As to the Western Crown Cork and Seal problem, the estate will deliver that free and clear and will fight out the rights with the conditional sales claimant. The Receiver is not selling the following items: Cash on hand or accounts receivable existing prior to the commencement of the debtor proceedings or now created and existing on behalf of the Receiver. The Receiver will obtain from the purchaser a prorotation on the existing business insurance. The Receiver is not selling a promissory note of the Loma Linda Company which has a present balance of approximately \$4300. The Receiver is not selling the right to the cash surrender value of life insurance to Thompson and Greene which we understand has a present value of approximately \$1500.

Now, is that clear, Mr. Katz?

Mr. Katz: I can't carry all that in my head. Mr. Levinson read the terms of the bid. We bid on those terms. The variation was with respect to the lease and we varied it. After we make our bid—I am not saying there are any changes in your terms from what Mr. Levinson read—but we are prepared to complete the bid as we made it on the basis of the Miller bid, subject to only one change, subject to the right and title to the lease, subject to the condition that whatever rights Thompson and Greene have, inure to the benefit of the purchaser.

Mr. Gendel: If your Honor please, before the bidding went into its higher brackets, I read the items which have now been again itemized and I think to eliminate any question of the items as specified should be conceded by the buyers because that is the basis on which the Receiver can sell and now is the time to do it.

The Referee: I think practically all you have said, and as I understood it thoroughly, is that these bidders are not buying the accounts receivable and they are not taking over the cash, but that they were getting the lease in, as and when they were getting it.

Mr. Katz: Let's have the transcript made up.

Mr. Gendel: The other items that were specified by the Miller bid is that we understand that the bidder is not buying any rights in and to those items which are pledged, one, with the Bank of America, and two, the two items at Fresno, being the Monarch wines and the raisin syrups. My only purpose is that the buyer should not be in a position [22] at a later date to feel that any items were contended for by the Receiver, that it had not been revealed to him at the time of the confirmation of the bid.

Mr. Lynch: The bidder will take this business over as of what date; and will continue to operate, and what will happen to the profits, if any, that are derived from the operation of this business?

Mr. Gendel: Mr. Katz, do you want it tonight?

Mr. Katz: I think we want to get the order.

Mr. Rosen, on behalf of the debtor corporation, is there any objection to the sale, just for the record?

Mr. Rosen: With as much power as I have, with no board of directors meeting, I have no objection on behalf of the corporation.

The Referee: This meeting is adjourned. The sale is confirmed for \$161,000 to Samuel C. Rudolph & Associates, Incorporated, a corporation.

In the District Court of the United States, Southern
District of California, Central Division

Before Hon. Hugh L. Dickson, Referee.

State of California,
County of Los Angeles—ss.

I, P. A. Tsokas, official reporter, pro tempore, of the above-entitled court, do hereby certify that the foregoing pages 1 to 23, both inclusive, comprise a full, true, and correct transcript of the proceedings in re hearing on plan for sale of property.

Dated this 6th day of November, 1947.

/s/ P. A. TSOKAS,

Official reporter, pro tempore.

[Endorsed]: Filed April 13, 1948.

[Title of District Court and Cause.]

HEARING ON ORDER TO SHOW CAUSE
RE WIL-RUD SALE

The following is a stenographic transcript of the proceedings had in the above entitled cause, which came on for hearing before the Honorable Hugh L. Dickson, Referee in Bankruptcy, at his courtroom, 343 Federal Building, Los Angeles, California, at ten o'clock a.m., November 7, 1947.

Appearances:

GENDEL and CHICHESTER,
By MARTIN GENDEL, ESQ.,
Appearing on behalf of the Receiver.

CHARLES J. KATZ, ESQ.,
Appearing on behalf of
Wil-Rud Corporation.

E. A. LYNCH,
Receiver.

Mr. Gendel: I think we can rather briefly summarize the position of the Receiver in this case. Your Honor will recall the rather spirited bidding we had between the two entities, Mr. Rudolph and Mr. Miller, with the ultimate result that Mr. Rudolph's bid of \$161,000 was accepted.

When the items were checked out to Mr. Rudolph's corporation, that is, his nominee, the Wil-Rud Corporation, they then compared the items

found in the original inventory taken under the Debtor's direction when the Debtor first came into the reorganization proceedings as against the items that were turned over to them by Mr. Lynch. They came up with two pages of items. We have a copy of that which I believe the Wil-Rud Corporation furnished to us. That copy shows alleged shortages of \$15,488.99, and alleged errors in addition amounting to \$3,463.17, or a grand total of \$18,952.16.

The Wil-Rud Corporation then said to the Receiver, "This bid is made on a proportionate basis of about forty to forty-five cents on the dollar as to the inventory, therefore, we want a pro rata adjustment."

The matter was then referred to my office and here is our position as far as we are concerned, legally. We sold the physical assets as of five o'clock p.m., October 15, 1947. Save and except for the water softener, those assets belonging to the Debtor were sold free and [2*] clear of encumbrances. We did not sell pursuant to any inventory, as is very often the case in these auction sales. It was physically impossible for the reason that the Receiver did not have an inventory in the first instance, and secondly, every one knew the Receiver had been selling items during the time he had been in possession.

I would like to refer your Honor to the order confirming and approving the sale, which order was approved before it was submitted to your Honor

* Page numbering appearing at top of page of original Reporter's Transcript.

by counsel for the purchaser. I think that order estops us from going any further. I would like to refer to paragraph 1 on page 2, commencing at line 24. I don't know whether I have the date of signature or not, but I believe it was signed on the twenty-second of October.

The Referee: The twenty-second of October, you say?

Mr. Gendel: Yes, your Honor; it was signed by your Honor on the twenty-second of October.

Mr. Katz: It is headed "Order confirming and approving sale."

The Referee: I have it.

Mr. Gendel: If you will turn to page 2, line 24, your Honor, you will find what we sold with reference to the physical assets:

"The Receiver, by this order, is deemed to have sold, and does sell to the buyer, all machinery, fixtures, equipment, all inventory, all lessee's improvements, all [3] furnishings, all supplies, and all finished and unfinished products of every class and character and description whatsoever located at 3631 Union Pacific Avenue, Los Angeles, California, together with all the other physical assets of the debtor corporation, wheresoever situated, and together with all of the physical assets of every class and character of the Yankee Doodle Root Beer Company, a corporation, as of October 15, 1947, at 5:00 o'clock p.m.; . . ."

As far as the Receiver is concerned, that was the sale, nothing else. We didn't sell by inventory. As

I have indicated to the Court, that would *have been* possible. As a matter of fact, by virtue of that paragraph, we gave to the purchaser more than he bid for. Actually he bid for the shares of stock of the subsidiary corporation. That was the Miller bid,—not for the physical assets of the subsidiary corporation. When that problem was raised between Mr. Katz' office and myself, I believe I indicated to your Honor before the order was submitted that we felt it was only fair to the purchaser, who was obviously attempting to buy the physical assets located at the plant, that we sell him the assets directly instead of selling him a corporation in which he might have difficulty clearing title. So we granted to him that concession. But we cannot go farther back and say any sale was made pursuant to an inventory taken at the beginning of these proceedings. [4]

I don't know whether or not your Honor has read the transcript of the hearing on the sale.

The Referee: No. I will get Miss Marsh to bring it in to me.

Mr. Gendel: While that is being done, if the Court please, I will point out on page 21 of the transcript what occurred when the bidding was completed, and in order that there may be no question about it, I think it might be well perhaps to start on page 20 at line 21. I was speaking at that time:

“May I, on behalf of the Receiver, make a closing statement in connection with what I understand

the Receiver wants to confirm as part of the sale so that there is no question.

“The Receiver is selling to the buyer all of his right, title and interest in and to the lease of the premises in question occupied by the debtor corporation.”

Mr. Katz: That is after the bidding had been completed?

Mr. Gendel: That is correct. (Reading) “The Receiver is likewise selling the Receiver’s interest in stock certificate No. 6, representing three shares of Yankee Doodle Root Beer Company, a corporation, which we have been told are all of the issued shares of the subsidiary company. The Receiver is selling the machinery, equipment, and fixtures located at the place of business of the California Associated Products Company, 3631 Union Pacific Avenue, . . .” [5]

The Referee: What page is that?

Mr. Gendel: We are now on page 21, your Honor.

The Referee: I have it. Go right ahead.

Mr. Gendel: I am just coming onto line 9, which is the key to our position here. (Reading further) “. . . 3631 Union Pacific Avenue, and the inventory is now subject only to the balance owing on the water softener of \$1699.17.”

In other words, at no time was there any reference to this physical written inventory as being part of the sale and as to the items being sold as is reflected by the approved order. We sold only

those things which the Receiver could convey title to as of October 15, 1947.

I might also point out for the record that the purchaser obligated himself to take the things on a pro rata basis that would net the estate approximately \$1000 more than the cancellation of the insurance as of the date of the close of sale. The purchaser contended that there had been over insurance in the sense that too much insurance had been——

Mr. Katz: Does that have anything to do with it?

Mr. Gendel: I think the Court should have all of the facts about the final order and what led up to it.

Mr. Katz: I have no objection to the order as it reads. The only question is what it means and in order to determine what it means we read the order by its four corners and the transcript of the proceeding as distinguished now from [6] going into collateral matters.

Mr. Gendel: I cannot conceded that position.

Mr. Katz: All right.

Mr. Gendel: I don't think it is a collateral matter. It shows the background leading up to the approval of the order which in my opinion consolidates all of the rights of the parties.

Mr. Katz: I don't disagree with that. The Court can look at the order and read the transcript and I think that tells the story.

Mr. Gendel: I don't think we have to back up

to the transcript. I think that order reflects the negotiations of the parties and reflects the agreement between the parties as well as the order of the Court.

Although the bid was on a proration of the insurance, the point raised by the bidder after the sale was that there was over insurance and supposedly the insurance companies were not board companies. taking that statement at its face value, we discussed with your Honor the right of a receiver to permit what the buyer wanted and that was a termination of the policies, a cancellation. Upon that representation the Receiver then conceded the request of the buyer, which is enumerated as part of the order, and allowed the termination of the insurance which cost the estate a little over \$1000. Mr. Lynch recently informed me that the major portion of the insurance was in [7] board companies, but we have made that deal and we are not backing up on it.

I believe that this order, particularly that portion of it contained at the top of page 3, saying that we are selling the physical assets as of October 15, 1947 at 5:00 o'clock p.m. is the answer to our Order to Show Cause. I therefore feel that the purchaser should be directed forthwith to pay over the balance of the moneys.

Mr. Katz: There are a number of matters I should like to discuss, your Honor. Obviously, the purchaser is prepared to pay everything he owes and it will take no strong arm of the Court, Judge

Dickson, to require him to do so. However, there are a number of problems before us.

First, let me talk about the inventory problem, and then refer to the second problem which Mr. Gendel mentioned. If your Honor will turn to page 2 of the order, line 16, “. . . the undersigned Referee does hereby approve and confirm the sale by E. A. Lynch, as Receiver in the within estate, of certain personal property, hereinafter described, to Wil-Rud Corporation, a corporation, for a cash consideration to be paid to said E. A. Lynch, as Receiver, in the sum of \$161,000, delivery of the assets to be made upon the signing of the within order, and payment therefor to be made concurrently with delivery to the buyer.” [8]

Our point there is that considerable quantities of these assets have not yet been delivered to us and until they are delivered we contend we have paid by far more than the pro rata for what we have received. We are prepared to pay the purchase price as finally determined concurrently with the delivery to us of possession of the assets. As I said, a number of the assets have not been delivered, but I will take that matter up later. I don't think it is necessary to put the cart before the horse and make an order before your Honor is satisfied that the Receiver himself can complete the matter by delivering possession which is a condition to the payment. On that phase of it, when I finish answering Mr. Gendel, we will discuss the question of delivery of possession.

Now, let us take up the problem as Mr. Gendel raises it concerning the assets. The Court is in possession of the basic factual situation. The shortages, Judge Dickson, are enumerated on this sheet. I will show it to counsel and have it marked as an exhibit. Here is a copy (handing document to Mr. Gendel).

Mr. Gendel: Why don't we turn in for the Court's convenience a typed copy?

Mr. Katz: Suppose we have it marked Exhibit 1, an instrument headed "Inventory shortages at California Associated Products Co., Inc."

(The document was marked Petitioner's Exhibit 1.) [9]

Page	Item No.			
11	O151	1	Kardex	\$54.00
47	M307	1	Lot Scrap	25.00
49	M334	1	Lot Conduit Pipe, etc.	50.00
49	m335	1	Lot Scrap Lumber	50.00
50	M350	124	Pallets	93.00
51	M360	27	Reflectors	2.00
57		3	Gal. Cola Syrup	1.00
57		21½	Cases Celery Phos. Quts.	3.25
57		1	Cases Celery Phos. Pts.	2.75
57		1½	Cases Skin Lotion	1.50
57		1	Cases Grenadine Syrup	1.50
57		2	Cases Almond Extract	6.00
58		½	Lb. Nutmeg Oil	5.75
58		¼	Gal. Rum Ether	1.75 lb.
60		1	Gal. Plantarome	8.00
64		1	Lb. Grape imitation	4.00
64		1¼	Lb. Lemon Oil Concent.	14.00
64		2	Lbs. Lemon Oil Concent.	17.00
64		12	Oz. Mandarin Oil	6.00 lb.
64		1	Oz. Strawberry Flavor	4.00
65		1	Gal. Raspberry	1.00
65		2	Lbs. Minci Pardi	20.00
65		1	Lbs. Heavy Wine Oil	3.00
66		¼	Gal. Caramel Color	4.00
66		1	Gal. Pineapple Papaya .....	.53
66		5	Gal. Root Beer Oil	2.50
				215.00
				6.00 lb.

Page	Item No.			
67	2	Lbs. Red Color No. 2.....	4.85	9.70
67	1	Gal. Raspberry Extract		20.00
67	175	Lbs. Pectin.....	1.27	222.25
67	1 1/2	Gal. Vanilla Flavor.....	11.00 lb.	132.00
68	1 1/2	Gal. Sloe Gin Color.....	4.00 lb.	16.00
68	3	Gal. Strawberry Color.....	2.00 lb.	48.00
68	1 3/4	Gal. Oil of Lime Distilled.....	8.00 lb.	112.00
68	1 qt.	Almond Flavor.....	2.75 lb.	5.50
69	3 qt.	Lemon Extract Terp.	2.65 lb.	11.40
69	3 qt.	True Blackberry Cone.....	22.50 gal.	16.20
70	2 gal.	Caramel Color.....	1.22	2.44
70	12	Corn Syrup.....	23.00	276.00
70	20 gal.	Grape Flavor XX.....	6.65	133.00
70	165 gal.	Caramel Color.....	1.22	201.30
70	1 gal.	Hypro.....		1.50
70	16 bt.	Hydro Chloric Acid.....		134.40
71	75 lb.	Menthol Sylicilate.....		28.50
71	8 gal.	West Disinfectant.....	3.50	28.00
71	10 gal.	Apple Juice.....	.75	7.50
71	1 gal.	Glycerine.....		1.20
72	35 lbs.	Kelite Alklor.....	.12	4.20
73	796 gal.	Liquid Sugar (No. 6368).....	.08148	536.06
73	578 gal.	White Grape Concentrate.....	2.84	1641.52
73	3000 gal.	Red Grape Concentrate.....	2.27	6810.00
74	2 bbl.	Red Grape Concentrate (100 Gal.).....	2.27	227.00
75	1 case	12 oz. Bottles Screw Top (24).....	4.83 Gr.	.80
75	3239	Cases of 12 (270 Gr.) Screw Top.....	7.77 Gr.	2097.90
77	49	Cases of 7200 Bottle Caps (352800).....	2.41 M.	850.25
77	8	Cases of 7200 Bottle Caps (YD) (57600).....	2.41 M.	138.81

The Referee: Was this made up by the Receiver?

Mr. Katz: Yes.

Mr. Gendel: Mr. Yates tells me they used the shortage claim sheet as prepared by Wil-Rud Corporation and prepared it from that sheet, eliminating a couple of items which they felt were not proper.

Mr. Katz: Just a moment. The Receiver and the purchaser sat down with the inventory and made a verified physical check as between the items which were on hand and the items which were listed on the inventory. Is that correct?

Mr. Gendel: That is the exhibit that is now before the Court.

Mr. Katz: No. Just a moment. Mr. Yates, suppose you take the stand. We will try to get some facts before the Court.

RALPH J. YATES

called as a witness on behalf of the Petitioner, having been first duly sworn, testified as follows:

Direct Examination

By Mr. Katz:

Q. Mr. Yates, you are employed by the Receiver in this proceeding, Mr. Lynch, is that correct?

A. That is correct. [10]

Q. Shortly after the sale in these proceedings you met with the successful purchaser, did you not, and began checking out the items to the purchaser?

(Testimony of Ralph J. Yates.)

A. I met with the purchaser and arranged for the representative of Mr. Lynch to check with the representative of the purchaser.

Q. Who is that representative?

A. I don't know his last name. Mr. Rudolph can give it to you.

Q. Was it Keenan? A. I mean your man.

Q. Who was your man? A. Steve Beatty.

Q. Is he here?

A. No, he isn't, but I checked the findings of both representative at the conclusion.

Q. You have a physical inventory, did you not, of the various assets of the debtor corporation?

A. We had an inventory presented to us that was taken as of July 28.

Q. There had been certain changes made in that inventory subsequent to July 28?

A. There had been sales made.

Q. The sales were taken from the inventory, were they not?

A. They were on the final inventory. In other words, [11] they used sugar and they sold some grape concentrates and sold some supplies in the operation of the business.

Q. You prepared a final inventory which eliminated the items that had been sold, is that right?

A. I prepared an inventory which corresponded with the check-out record of the Receiver and the purchaser.

(Testimony of Ralph J. Yates.)

Q. Where is that inventory which you prepared?

A. That is the inventory marked Exhibit 1.

The Referee: This one (indicating)?

The Witness: That is correct.

Q. (By Mr. Katz): What did you check against when you were ascertaining what the shortages were? Did you have an inventory to check against?

A. The physical count with the original inventory as of July 28.

Q. Where is that physical inventory of July 28?

A. It is on your desk.

Q. In order to determine what went to the purchaser and what did not, you took an actual physical check and you compared it with the inventory which I now show you, is that correct?

A. That is correct.

Q. Then you determined that certain items were short, is that right?

A. I checked the findings of the Receiver's representative with the findings of the purchaser's representative [12] and prepared this statement, and we agree on the statement in so far as the figures are concerned and the amount.

Q. Before Mr. Rudolph purchased or made any bid in this case, do you know whether the inventory of July 28, 1947 was handed to him?

A. Yes, it was.

Q. You handed it to Mr. Rudolph?

A. I did.

(Testimony of Ralph J. Yates.)

Q. Do you remember the date that you handed it to Mr. Rudolph?

A. About ten days before the first bidding. There were two meetings of the bidding.

Q. Who asked you to hand this inventory to Mr. Rudolph before he made any bids?

A. Mr. Rudolph, and Mr. Blum was with Mr. Rudolph.

Q. Have you handed this inventory to any of the other bidders? A. I had.

Q. And the instrument which I show you is a copy of the inventory which you handed to Mr. Rudolph some time before he started making the bids, is that right?

A. It is the same one I handed to him.

Mr. Katz: I would like to have this marked as an exhibit, the inventory.

The Referee: All right. [13]

Mr. Katz: That is all at this time.

(The inventory was marked Petitioner's Exhibit 2.)

Q. (By The Referee): This shortage sheet shows a shortage of \$18,952.16, is that right?

A. That is correct, as compared with the inventory as of July 28.

Q. In other words, that \$18,952.16 represents what you had sold?

A. Not what Mr. Lynch had sold, your Honor, but about three days after the inventory had been

(Testimony of Ralph J. Yates.)

taken there was about \$8000 of grape concentrates that were sold by the Debtor. Mr. Lynch did not take possession until the latter part of August. That was short. Most of the items—As a matter of fact, all of those items, I would say ninety-five per cent of them, were short. The same shortages existed at the time Mr. Lynch took over.

Cross-Examination

By Mr. Gendel:

Q. Mr. Yates, when you handed this original or copy of the original inventory to Mr. Rudolph, did you have any conversation with him at or about that time concerning the sale of concentrates?

A. Yes, I believe I told him that we had a market price on the concentrates of about eight-five cents a [14] gallon.

Q. Did you tell him whether any had been already sold?

Mr. Katz: I object to that as leading and suggestive.

The Referee: Yes, I think that is so. Ask him what he told him, if anything.

Mr. Gendel: They put Mr. Yates on as their witness, your Honor, and I am cross-examining him. Maybe it is slightly leading, but I want to get the facts here.

The Referee: All right, go ahead.

Q. (By Mr. Gendel): What was the subject matter of your conversation, if any, with Mr. Ru-

(Testimony of Ralph J. Yates.)

dolph at or about the time you handed him Exhibit 2 concerning the concentrates?

A. I told Mr. Rudolph that we had not taken a physical inventory, that Mr. Lynch had been operating the business and the Debtor had been operating the business since July 28, and naturally there would be adjustments on the merchandise that had been used in connection with the operation of the business. I don't recall at this time any specific items that I mentioned.

Q. This column that you prepared entitled "Shortages," that is actually a difference in the items that were reflected on the inventory and the items that were offered or delivered to the Wil-Rud Corporation, is that it?

A. That is correct. It ties in with the physical check of the representative of the Receiver and the representative [15] of the purchaser.

Q. Added to those items are some additional mistakes that somebody made who prepared the original copy of July 28, is that correct?

A. That is correct.

Mr. Gendel: That is all.

Mr. Katz: That is all, Mr. Yates. Now that we have the physical background before the Court, your Honor, the bidding was done in a rather chaotic way as I remember. A reading of the transcript will reflect the cardinal facts. At page 3, line 19 of the transcript is the bid which was the original basis for all other bidding:

“The undersigned proposes to pay for all of the outstanding shares of Yankee Doodle Root Beer Company, and for the physical assets of California Associated Products, subject to the following exceptions, the sum of \$135,000. In addition to the foregoing, we are to receive all trade names, trademarks, all formulas, and registered trade styles, and the lessee’s interest in the lease, . . .”

Then we go down to line 18, and here it is very clear what is excepted:

“We are not to receive any of the merchandise held by the Bank of America as security for its pledge or any items held at Fresno to secure two pledges of firms located there. Nor are we to receive the cash on hand, [16] accounts or notes receivable, or deposits made by those corporations.”

That is the Miller bid.

“We will take over the existing insurance on a pro rata basis. Title to all property delivered to us is to be free and clear except the water softener.”

Your Honor will note there isn’t the slightest exclusion of any kind excepting the items which are specifically excluded in the bid itself.

“We are not to receive any of the merchandise held by the Bank of America as security for its pledge or any items held at Fresno to secure two pledges of firms located there. Nor are we to receive the cash on hand, accounts or notes receivable, or deposits made by those corporations. We will take over the existing insurance on a pro rata

basis. Title to all property delivered to us is to be free and clear except the water softener.”

Then we go on to page 5, completing that bid.

“A check for \$10,000 is tendered herewith as evidence of good faith. Confirmation of the sale is to take place on or about October 20, 1947.”

After that bid was read, the bidding began, not on the basis of what Mr. Gendel said at page 22 after bidding was completed. Your Honor requested that the bids be made on the basis outlined in the Miller bid so it would be possible to compare them and possible for the creditors [17] and your Honor to evaluate which bid was the better bid and which bid was not.

A problem arose with respect to the lease and what was meant by the clause in the Miller bid which said “The lessee’s interest in the lease.” And instead of continuing to bid strictly on a basis of the Miller bid, it was understood with respect to the lease that the purchasers were not to receive any warranty of any kind from the debtor corporation, but the purchasers were to receive such equity, if any, as the estate might have in the lease, and in addition if the officers of the debtor corporation had any understanding concerning that lease it was to be the determination of this Court that such understandings which they held they held as resulting trustees for the benefit of the purchasers.

It was not until after bidding was completed and after we had bid \$161,000 that Mr. Gendel begins his statement at page 20 which he read to the

Court. Bear in mind, your Honor, in his own statement there he does not say there will be no pro rata adjustment to the purchaser. He says they are selling the inventory as is. All of us are not children. We know what inventory as is means. It means you are not warranting its quality, you are not warranting its condition. However, I have never heard of a time when a purchaser was not entitled at least to a check as to the amount and as to extension. [18]

While I do not practice here as much as I would like to, nevertheless, during some twenty-five years of practice here I have never heard it said that a receiver or trustee when selling assets does not at least give you a verification as to the quantitative count. When you buy as is, it means you take it in its state, but it does not mean if you agree to pay \$161,000 you don't get what is coming to you. Taking the logic of Mr. Gendel's argument, if there was nothing on hand on October 15, 1947, then we would be paying \$161,000 for nothing—says Mr. Gendel. How do you accept his compromise without going to the logical conclusion I just advanced? He says whatever was on hand on October 15. If there was nothing on hand on October 15 we still would pay \$161,000?

The Referee: As is means what was there at that moment.

Mr. Gendel: That is what it means, Judge.

The Referee: As is now means what is right there now.

Mr. Katz: All he says is this, your Honor,—not as is now—let's read paragraph 1 of the order which says:

“The Receiver, by this order, is deemed to have sold, and does sell to the buyer, all machinery, fixtures, equipment, all inventory, all lessee's improvements, all furnishings, all supplies, and all finished and unfinished products of every class and character and description whatsoever located at 3631 Union Pacific Avenue, Los Angeles, [19] California, together with all the other physical assets of the debtor corporation, wheresoever situated, and together with all of the physical assets of every class and character of the Yankee Doodle Root Beer Company, a corporation, as of October 15, 1947, . . .”

That “as is” was simply the date when possession was to be delivered to the purchaser. But in the bid which we were bidding in open court there isn't the slightest, not the slightest suggestion of any cut-off date with respect to quantitative count. The only cut-off date is the date on which we are to take possession and the transaction is to be closed; we are to get the assets wherever they are situated, that is, of the debtor corporation. There is no statement as of on hand on October 15, 1947. How can we accept the argument of Mr. Gendel: If there was nothing on hand, according to his theory, we would have paid \$161,000 for nothing?

The Referee: No, I couldn't follow along with that.

Mr. Katz: If you want to follow with that theory then we cannot take the first step, because if we take the first step we must take the second.

The Referee: A man must get what he bargains for.

Mr. Katz: Then let's go on with the order itself and look at the equities in this thing. I have read the bid on which Mr. Rudolph made his offers. Mr. Gendel, for the first time after bidding is completed, read in [20] a number of exceptions which were not included in the Miller bid.

Mr. Gendel: I don't think you know the record when you say that, Mr. Katz.

Mr. Katz: If I don't know the record I can't read English. I am reading from the transcript.

Mr. Gendel: Then you can't read English. Start reading at page 5, at the bottom, before you made any bid on behalf of the Wil-Rud Corporation or any one else. That is where your exceptions are stated.

Mr. Katz: The bid that was made by my client was made precisely on the basis that this transcript shows and not on the basis of your attempt to vary the proposal as made by Mr. Miller as against which we were bidding. So that your Honor will not become confused as I have become confused, the Miller bid is found in the transcript of the hearing in re sale held on October 15, 1947, from pages 3 through 5, beginning on line 19 of page 3.

Does your Honor have it?

The Referee: I have it.

Mr. Katz (Reading): "The undersigned proposes to pay for all of the outstanding shares of Yankee Doodle Root Beer Company, and for the physical assets of California Associated Products, subject to the following exceptions, the sum of \$135,000. In addition to the foregoing, we are to receive all trade names, trademarks, all formulas, and [21] registered trade styles, and the lessee's interest in the lease. We are not to receive any of the merchandise held by the Bank of America as security for its pledge or any items held at Fresno to secure two pledges of firms located there. Nor are we to receive the cash on hand, accounts or notes receivable, or deposits made by those corporations. We will take over the existing insurance on a pro rata basis. Title to all property delivered to us is to be free and clear except the water softener. A check for \$10,000 is tendered herewith as evidence of good faith. Confirmation of the sale is to take place on or about October 20, 1947."

That is the bid. Mr. Gendel attempts to make a statement of qualification, and he says, "The last item we would like to retain, unless the bid is increased by a comparable amount, . . ." And we increased the bid from \$135,000 to \$161,000.

(Reading further): ". . . would be such rights as belong to the estate arising from the payment of life insurance by the debtor corporation on the lives of Thompson and Greene."

Your Honor then calls the attention of the parties to a petition in reclamation. Then we go on——

Mr. Gendel: Don't you think it would be well to read this to the Court, "I thought it well to point out those problems to the prospective bidders, your Honor, so [22] that there wouldn't be any confusion after the highest bid is accepted."

Mr. Katz: Did you make any statement that if there were any individual shortages in any statement anywhere—just answer that yes or no—if there were any individual shortages, that the purchaser would still have to pay \$161,000? Do you find that in the transcript?

Mr. Gendel: It wasn't necessary because the Miller offer says existing assets and not non-existent physical assets.

Mr. Katz: Will you answer that question? Mr. Reporter, will you read it back to him. You have asked if I read the transcript carefully.

(Whereupon the pending question was read by the reporter.)

Mr. Katz: Let's look at page 9, where Mr. Katz says, "We are prepared to bid, Judge Dickson, on the same basis as I have just actually asked so we know what we are talking about. If Mr. Levinson would indicate exactly whose bid it is, we intend to bid on the same basis as the bid that he labels so that we know what we are talking about.

"The Referee: I understood him to mention a Mr. Miller. It was a creditors' committee bidder.

"Mr. Katz: We are prepared to bid on the basis of that bid and bid higher."

Then we go to line 23: "Mr. Katz: So there is no [23] question, do I understand that the bidding now is on the basis of a sale by the Receiver pursuant to his equity power to sell the assets as distinguished from any plan?"

"The Referee: That is the way I understand it."

We then bid \$137,500. There is nothing, nothing in this order, which if fairly construed, requires any change in what is the general principle of equity, and that is this, that a man is entitled to what his seller purports to sell to him. Mr. Yates testified he showed Mr. Rudolph this inventory and he told Mr. Rudolph there would be some adjustment. If the inventory had no place in this proceeding at all there would have been no reason for having an inventory, it never would have been shown to us, and there would have been no reason for Mr. Gendel to have made reference to the inventory that he made on page 20.

Mr. Gendel: That is not the same inventory.

Mr. Katz: May I be permitted to continue?

The Referee: Yes. Let's not interrupt. Let each speaker finish.

Mr. Katz: Line 21. If Mr. Gendel was talking about inventory of machinery I think he should have said so. We paid \$161,000 for these assets. All Mr. Gendel was seeking to obtain was that if he was to be permitted to exclude the life insurance and to exclude the \$4300 item that we agreed could be excluded, he wanted to be sure the bid that was

received was at least an amount above \$135 and in a sum [24] which cancelled out those rejections, and we paid \$26,000 more.

I would simply like to say to the Court that there is nothing in this order confirming the sale, and I as one of the persons who participated in drafting it never dreamed for one moment that there was anything in the order that would block out the equitable proposition existing which says that every time a person buys something and checks it over, the thing's bought, nothing which would prevent us from coming in after that and asking what was rightfully due us. The exceptions were only those contended for in the bid of Mr. Miller. Those were the items at the Bank of America and the items at Fresno. The date of October 15, 1947 was the date for the surrender of possession to us of those assets.

Now, I would like to put Mr. Rudolph on the stand and get his conversation with Mr. Yates so that the Court may have the balance of that background.

The Referee: All right. [25]

SAM RUDOLPH

called as a witness on his own behalf, having been first duly sworn, testified as follows:

Direct Examination

By Mr. Katz:

Q. Mr. Rudolph, you are connected with the

(Testimony of Sam Rudolph.)

Wil-Rud Corporation, the purchaser in this proceeding? A. I am.

Q. About ten days before you made any bid in this proceeding did you go down to the place of business of the California Associated Products Company? A. I did.

Q. At that time were you handed an inventory by the representative of the Receiver?

A. That is right.

Q. Were you able simply by going through the plant, for instance, to determine whether the quantity of concentrates on hand in the premises was actually the same amount which was shown on your inventory?

A. There was no way to tell at all. They handed me the inventory and told me that was there and the only thing that was sold out of the inventory was some Monterey grape juice, or something, to a party by the name of Briggs. That was the only thing that they told me was sold.

Q. In your claim for shortages, did you make any [26] claim for any item like that Briggs Monterey situation? A. No, sir, I did not.

Q. All you were told was sold was this one item?

A. That is correct, sir.

Q. By simply looking at the plant were you able to determine whether there were eight thousand gallons of grape concentrate as distinguished from five thousand gallons?

A. I think Mr. Yates did mention that there

(Testimony of Sam Rudolph.)

was 8000 because when I checked this inventory he told me, "Sam, I think one mistake is on that eight thousand that was supposed to be there when we took this stock over." We took for granted an inventory taken by the Receiver or Trustee is always correct and we have bought goods for the last twenty-five or thirty years and we don't do a lot of checking when we go in and look at an inventory because we know when they check an inventory it is correct. They do make allowances when they are short or over. The reason we didn't pay the balance of the \$161,000, we wanted to check and see if they were going to make good. We checked it once and they were dissatisfied and we had another man go over and make the second check.

Q. Who checked the second time?

A. It was checked by the Receiver's man twice. They thought there was something wrong and they rechecked it again. Not only that, but they pointed out it was short and [27] they would make it good.

Q. Who said that? A. Mr. Yates.

Mr. Gendel: I move that be stricken, your Honor. I don't see how Mr. Yates could bind the Receiver in this case.

The Referee: No, he couldn't bind him, but I have an old-fashioned idea that a man should not be led into a false position by anybody's representative.

Mr. Katz: That is all.

(Testimony of Sam Rudolph.)

Cross-Examination

By Mr. Gendel:

Q. You talked to a gentleman at the place of business by the name of Stuckwich when you first went out there? A. Yes.

Q. Did you have any conversation with him concerning the inventory?

A. The only thing he had Yates——

Q. Did you have any conversation with him?

A. Well, I don't know whether I did or not with respect to inventory, but Mr. Stuckwich told me the same thing, that there was some Monterey grape juice that was sold.

Q. Is that all that Mr. Stuckwich told you [28] with reference to the items in the plant compared to the original inventory? A. That is correct, sir.

Q. Did Mr. Stuckwich tell you in substance that this business had been operated by the Debtor after the inventory was taken and had been operated by the Receiver after the inventory was taken?

A. I didn't know it.

Q. Did he say anything about that to you?

A. I didn't know anybody was in there before Mr. Lynch went in there. There was nothing discussed about that at all.

Q. Was there anything said to you by Mr. Stuckwich?

A. There was nothing said by Mr. Stuckwich because I don't think I had five minutes conversation with Mr. Stuckwich.

Q. Isn't it true Mr. Stuckwich told you this

(Testimony of Sam Rudolph.)

inventory, referred to as Respondent's Exhibit 2, was the inventory taken when the Debtor proceedings commenced on July 28, and that those items as set forth on the inventory were not all there because there had been operations by the Debtor and the Receiver?

A. No such statement was made to me by Mr. Stuckwich.

Q. What is it you say Mr. Yates told you about the shortages?

A. Mr. Yates did not say anything about shortages. He said, "You understand that they sold the Monterey grape juice." In going through the plant there was a lot of cases of grape juice.

Q. I just asked what he said to you.

A. I am telling you.

Q. About the subject matter of shortages.

A. The only thing he told me was sold at that time was the Monterey grape juice.

Q. That is all Mr. Yates told you?

A. Yes.

Q. Prior to the time the bid was made on October 15?

A. That is correct, sir.

Q. You did not have any conversation with Mr. Yates about anything being made good or——

Mr. Katz: That is after?

Q. (By Mr. Gendel): Prior to October 15?

A. That is correct.

Q. Now, let's get to the conversation after October 15. When did that take place?

(Testimony of Sam Rudolph.)

A. It probably took place the next day after the sale was confirmed.

Q. Your recollection is you had a conversation with Mr. Yates on the 16th concerning shortages?

A. Yes, sir.

Q. Where did the conversation take place?

A. At the plant. [30]

Q. Who was present?

A. Who was present? I think Mr. Stuckwich was in the office and Mr. Smith at the time when it was pointed out to me the shortages.

Q. What did Mr. Yates say with reference to the subject matter of making good?

A. I never said anything about him making good at all. I didn't make any such statement about him making good. We were just checking the inventory at the time.

Q. I see.

A. Don't misunderstand. He didn't say he would make anything good.

Q. He didn't say the Receiver would make anything good, did he?

A. He said, "We were going to check it."

Q. All he said, "We are going to check out the inventory," is that it? A. That is correct.

Mr. Gendel: That is all. I don't know whether your Honor desires any further testimony. Mr. Lynch is trying to locate Mr. Stuckwich, but from this clarification of the direct testimony I doubt whether we need it. I would like to point out to the

Court that the bid of the Miller group was for the physical assets of California Associated Products. Mr. Katz referred to his twenty-five years of practice. I appreciate that is twenty-five years more or less [31] and therefore feel that with that experience and background he would be perfectly capable of drawing up an order if this proposed order was not proper. This was all he had to do: "All of those physical assets as contained in the inventory" or "As per inventory," just those three or four words, if they were buying pursuant to any inventory. Why use the language as approved by Mr. Katz, "The physical assets as of October 15, 1947 at 5:00 o'clock p.m."? We knew the order could not be submitted to your Honor on the 15th. As a matter of fact, we were still working on this order on maybe the 21st or 22nd of October. Therefore, that was the upset date and if anything disappeared between five o'clock on the 15th and the time your Honor confirmed the order, or any subsequent time when possession was tendered, then there would have to be an adjustment. That is the upset date.

I can't see any merit to the contention that if we sold them nothing they would have to pay \$161,000. We sold them what was there on October 15. They had an opportunity to make an examination. If it would be of any assistance to the Court, Mr. Miller is here. He is the one making the bid. I feel his writing speaks for itself, but he offers to testify he was bidding on what was there on the

15th. I don't think that is necessary, nor would it be binding on the Court.

The Referee: No, I don't think it is binding on the [32] Court.

Mr. Gendel: I feel the record is clear, that the situation with reference to checking out the inventory is an after-thought. I am satisfied if there were items out there that were not on the inventory in a substantial amount over and above, they would not have been turned back to us and not a word would have been said about the inventory. I cannot feel there is any inequity in the position of the Receiver. I pointed out what the Receiver did concerning the insurance and the free and clear sale of the subsidiary corporation. I think the Receiver has been eminently fair and that the order of sale as approved by counsel and approved by the Court should be binding on the purchaser.

Mr. Katz: Will Your Honor turn to page 23 of the transcript, line 4, as to what was meant by the as is clause. This is the Receiver speaking:

"Mr. Lynch: The bidder will take this business over as of what date, and will continue to operate, and what will happen to the profits, if any, that are derived from the operation of this business?"

"Mr. Gendel: Mr. Katz, do you want it tonight?"

"Mr. Katz: I think we want to get the order."

They were talking about what date the bidder wanted to take the business over, and that is the date of October 15, 1947. It is impossible to read the transcript [33] any other way. Mr. Lynch asks,

“The bidder will take this business over as of what date”? Now, if there was no inventory to be concerned with in this proceeding, if all we were to get was what was on hand there, then why would the Receiver check it out? What difference would it make? Why would they verify? Why would we be handed an inventory if it meant nothing? Mr. Rudolph could see and any person could see—either the Receiver hands an inventory to a person indicating that he wants to sell something based on the inventory or he hands him nothing.

With respect to the question of the fact that they excluded the proceeds of the sale, that is correct. They kept the cash on hand. We did not make any claim for cash on hand. They kept the cash on hand and we would get the pro rate for shortages. We couldn't get both.

When you read the Miller bid you will find they excepted the cash on hand expressly. True, there were sales, so the Receiver keeps his cash, but that doesn't mean the purchaser does not at least get a pro rate which isn't equal to the cash—he obviously got one hundred cents on the dollar—and in this case the pro rate runs something a little less than forty cents on the dollar. I have the figures somewhere.

The assets are \$415,000, and we pay \$161,000. The pro rate would be something less than forty cents on the dollar. [34]

Frankly, Judge, I am not concerned about all items, but certain large items, it seems to me, in

equity and good practice, we should not be required to pay for. For instance, take the shortage of 3000 gallons of grape concentrate instead of 8000 gallons.

The Referee: Where is that?

Mr. Katz: The item \$6,810.

The Referee: I see that.

Mr. Katz: And the other large items: The 3,339 cases of glass bottles. Bear in mind the Creditors' Committee came in and recommended \$135,000 and wanted it confirmed, and it was only the insistence of the Court that the matter be opened up for competitive bidding and that we were given a chance to bid and we bid \$26,000 more than that man.

The Referee: If you are entitled to this rebate or to these payments, then why aren't you interested in all of the items?

Mr. Katz: I am interested in all of the items, Your Honor.

The Referee: If you are entitled to any of them you are entitled to all of them.

Mr. Katz: I wanted to point out the larger items which would indicate the impropriety of the contention that the inventory meant nothing.

The Referee: I am not interested in that. They wouldn't [35] give you a great long document or even make it up if they didn't expect you to rely on it. Is there any question between you gentlemen as to the amount of the shortage. As I have it here, it amounts to \$18,952.16.

Mr. Gendel: I presume as moving party we are

entitled to a closing statement, if I may be permitted to make it.

The Referee: Oh, certainly.

Mr. Gendel: I would like to make this statement to the Court. The physical inventory taken on July 28, as I understand it, was taken by the Union Appraisal Company which would show what assets the Debtor was coming into Court with. That can be checked. Now, when the Receiver comes into possession he is charged with these assets. It is natural when he turns assets over to a buyer that he would require his man to check out those items so that he in turn can get a receipt for what he turns over—the other items being those items which were sold.

If counsel for Wil-Rud Corporation admits that he knew there were certain items of cash from sales, then he must have known from that very fact that there were sales. Certainly if we had sold a sizable amount of these assets before any bids were made or undertaken and the money was yet to come in—assuming we sold \$50,000 worth, is there any substance to the contention that because the \$50,000 worth of items were on this July 28 inventory and were not at the plant at the time Mr. Rudolph or any one else went [36] out to look at them, that nevertheless if the estate got it they would have to make a pro rata reduction for it? If so, then there was no purpose for the Receiver operating the business for profit or liquidation; then we were going to give the buyer all of the benefit of his operations

without any charges, et cetera. That doesn't sound reasonable to me. If they thought they were buying as per inventory, then a precaution should be taken by inserting that in the order. I can't see any justification in this particular type of sale, which is difference than the usual auction sale made directly off of the inventory and handed to bidders in court to check, but this was not an auction sale; this was a sale of a going business with interested parties who knew what was going on in the business and were buying the business as is and where is at that time.

They want an adjustment in mistakes in addition contained on various pages. Why don't we give them an adjustment on the fact this shows \$768,-344.83 worth of value. That is what the inventory shows. That is the exhibit before the Court. That is how ridiculous this argument is that we are obligated to give them an adjustment of items sold prior to the time that they even saw the place or figured out their bid or made their bid. I don't think there is any fairness to this afterthought.

As far as the Receiver is concerned, he is guided by the order of court as originally made and as far [37] as I am able to ascertain from anything said today we have complied with it. We tendered to Wil-Rud Corporation all of those assets which were in the possession of the Receiver as of October 15 at five o'clock p.m. We are not in a position, as I see it, on behalf of the estate, to give to the Wil-Rud Corporation the benefit of those sales which we

made for the estate prior to the date that this sale was made in this court. There has been nothing shown that Mr. Rudolph—who is an experienced purchaser, perhaps more so than any of us—when the inventory dated July 28 was given to him was sincerely relying upon that inventory when he was bidding in open court on October 15, 1947, having been in court and known about the operations and all the rest of it, to me that is not a justifiable act of equity on behalf of this Bankruptcy Court. In effect, it would be giving to the purchaser moneys sorely needed in an attempt to make a dividend payment to creditors. The question of adjustment on mathematical errors, as Mr. Lynch points out in his good handwriting, indicates how far they are reaching. Just because somebody made a mistake in adding up forty-seven thousand odd dollars they want an adjustment on that phase of it. There is no equity in their position and I don't think the estate should be burdened with an adjustment.

The Referee: Is there an agreement that there is a shortage of \$18,000? [38]

Mr. Gendel: The shortage is a physical shortage of \$15,000 and some dollars on Exhibit 1.

The Referee: \$15,488.99 and then errors in addition.

Mr. Gendel: Yes. Those are the mathematical errors I was talking about, nothing but errors in addition and subtraction. Whoever made up the July 28 inventory did not add or subtract properly, whatever it was. There was some mistake there.

Mr. Katz: Counsel's statement about the inventory being \$768,000 and why didn't we look to that as the amount we were asking is just nonsense, Judge Dickson, because the bid of the bidder on which we were making the bid: "We are not to receive any of the merchandise held by the Bank of America as security for its pledge or any items held at Fresno to secure two pledges of firms located there." Therefore, when you subtract that from the \$768,000 you come to the figure which I have given to the Court, which is some \$415,335. So let's not try to make an absurd position. It is perfectly simple and clear.

Now, as to the operation of the business for months and months, Mr. Rudolph knows nothing about that. He was handed an inventory, not months and months before he made his bid, but just before he came into court.

I say it is the duty of the Receiver in a case like that to say, "Don't look at that inventory." What did he show it to him for? But he was handed the inventory. [39] We are not making a protest against the good faith of Mr. Lynch, but we don't want him to make a protest against our good faith. We came into open court and paid \$161,000 for the assets. There wasn't the slightest suggestion in the transcript of the record which would not indicate that the ordinary adjustment between purchaser and seller in this kind of a transaction would not take place, something which takes place every

day when shortages develop. They are made every day and we think they should be made here.

The Referee: I am very much inclined to agree with you. I think a man ought to get what he buys, should get what he bids for. If he doesn't get it, he should not pay for it. You may prepare an order, Mr. Katz, to that effect.

Mr. Katz: There remains the problem, Mr. Gendel, which you and I should work out on the assets being turned over to us. I am talking about the bottles we never received. Do you want to discuss that?

Mr. Gendel: I think it should be discussed because we are apparently going to have some litigation on the matter.

Mr. Katz: I think we can reach a stipulation on the facts without taking the Court's time and then submit the question to the Court. Would you like to do that? I think Mr. Lynch and Mr. Rudolph can reach an agreement on what the facts are. [40]

Mr. Gendel: I don't even know what the problem is. If we can stipulate to save the Court time and properly present the facts, we will be glad to do it.

The Referee: Yes, let's do that.

Mr. Katz: I will prepare an order on this phase of it. On the other phase, let's put it over, say, about a week and see if we can get together.

Mr. Gendel: I don't know what it is about. There is nothing on the calendar.

Mr. Katz: Your order simply is to compel us to pay.

Mr. Gendel: That is right.

Mr. Katz: You say you have tendered the assets to us. Well, we want to pay you, but the order says we are to get the assets wheresoever situated.

Mr. Gendel: That is as of October 15.

Mr. Katz: Now, what happened was this. The Debtor had delivered various cases containing bottles, empty bottles or filled bottles of root beer. The customers and the storekeepers who had those cases had paid the Debtor, I think, sixty cents a case. We are entitled to those cases and we would like to get those cases from the customers.

Mr. Gendel: Are they shown as shortages on Exhibit 1?

Mr. Katz: They aren't short. They are in the possession of third parties.

The Referee: You gentlemen get together on a stipulation [41] of facts, if you can.

Mr. Katz: All right. Otherwise, we will bring on a separate proceeding.

Mr. Gendel: Correct. May we have proposed findings and conclusions and the order submitted to us so that we will have an opportunity to make suggested changes?

The Referee: Yes. I will hold it for five days.

State of California,
County of Los Angeles—ss.

I, Byron Oyler, Official Court Reporter, do hereby

certify that the foregoing forty-two (42) pages comprise a true and correct transcript of the testimony given in the above entitled matter.

Dated this tenth day of February, 1948.

/s/ BYRON OYLER,

Official Court Reporter.

[Endorsed]: Filed April 13, 1948. [43]

[Title of District Court and Cause.]

HEARING RE PETITION TO COMPROMISE
AND SALE OF ACCOUNTS RECEIVABLE

The following is a stenographic transcript of the proceedings had in the above entitled cause, which came on for hearing before the Honorable Hugh L. Dickson, Referee in Bankruptcy, at his courtroom, 343 Federal Building, Los Angeles, California, at ten o'clock a.m., Thursday, January 29, 1948.

Appearances:

GENDEL and CHICHESTER,

By MARTIN GENDEL, ESQ.,

appearing on behalf of the Receiver, E. A.
Lynch.

CHARLES J. KATZ, ESQ.,

appearing on behalf of Wil-Rud Corporation.

AARON LEVINSON, ESQ.,

appearing on behalf of Certain Creditors.

OVERTON, SELIG and WILSON,

By FRANK T. COTTER, ESQ.,

appearing on behalf of F. W. Boltz.

NATHAN E. GILLIN, ESQ.,

appearing on behalf of Yankee Doodle
Root Beer Bottling Company of San
Fernando Valley, Inc.

HUGH WARD LUTZ, Esq.,

appearing on behalf of Victor Kramer.

HUGO A. STEINMEYER, ESQ.,

appearing on behalf of the Bank of
America.

The Referee: California Associated Products
Company.

Mr. Goodstein: I am from the office that represents one of the larger creditors and we received no notice until yesterday, and counsel who was handling this matter had to leave town.

The Referee: Can't you pinch hit for him?

Mr. Goodstein: I don't know a think about bankruptcy proceedings at all.

Mr. Levinson: My own situation is this, Your Honor. I have to return to the Superior Court where I am waiting to be assigned.

The Referee: I am going to hear this matter, gentlemen.

Mr. Levinson: May I finish, Your Honor?

The Referee: Yes, sir.

Mr. Levinson: I have arranged to be available upon receipt of a telephone call and I might have to leave any minute. This will take quite a while.

The Referee: I am going right through with it. I am not going to string these things along to suit the convenience of attorneys. It has been noticed here. If you have not been able to be present that is too bad.

Mr. Levinson: I know, Your Honor, but what does one do in a case like this when they are on trial some place else?

The Referee: Tell the judge you have to be here and wait a while. [2*]

Mr. Overton: The same thing applies to the F. W. Boltz Corporation.

The Referee: The same answer to you, sir. I am not going to string these things along just because somebody is out of town or has to be somewhere else.

Are you interested in the California Associated Products, Mr. Gendel?

Mr. Gendel: I am, Your Honor. We have two matters before the Court this morning. One matter involves a compromise and settlement with Wil-Rud Corporation. For the benefit of those interested, as is set forth in the notice, the Wil-Rud Corporation

* Page numbering appearing at top of page of original Reporter's Transcript.

bid in open court \$161,000 for the assets of California Associated Products exclusive of certain items. The excluded items are not in dispute. After Wil-Rud Corporation had taken possession they complained to the Receiver that items which were in the original inventory taken on July 28 were not present at the plant. They worked out a master sheet showing items that were missing from the inventory and mathematical miscalculations totaling a gross amount of a little over \$19,000, \$19,336.86. The Receiver did not agree with the position of the purchaser and brought on an Order to Show Cause as to why the balance of the purchase price should not be paid as per the original bid. The Court held a hearing with reference to that one phase and indicated as far as the Court was concerned there would be a ruling that the [3] purchase was made relying upon the inventory and that therefore there would be an allowance on the missing items pro rata on the basis of the ratio between the purchase price and the inventory price, roughly forty cents on the dollar.

After the hearing it was discovered by the Wil-Rud Corporation that the wooden cases in which the bottles were transferred back and forth, in every instance that they could discover, had been more or less liened with each of the retail distributors or selling agencies, in the sense that the party purchasing the root beer had to give to California Associated Products sixty cents per case and that

was stamped on the inside of the cases in the possession of the retailers who were selling the product, and that they had already been confronted after taking possession, where in order to pick up cases from distributors who were not buying the product—since they needed the cases themselves—had paid out the sixty cents per case.

When that developed a conference was held between the Receiver and his representative and Wil-Rud Corporation and its attorney. We tried to figure out what might be a fair way to dispose of the problem. The Receiver was of the opinion, with due deference to the indication of the Court's ruling that the sale had not been made as per July 28 inventory and the purchaser well knew that items were being [4] continually sold since both the debtor in possession and the Receiver operated the business. However, the matter of the deposit on the cases was something that had not been brought to the attention of the Receiver and he was not aware of that factual situation at the time that the sale was announced in open court. And as a result, pursuant to both bids, the physical assets belonging to the California Associated Products Company or Yankee Doodle Root Beer Bottling Company of Los Angeles, a subsidiary, those items had been sold free and clear of any liens or encumbrances. So that as to that particular item the Receiver felt there was merit to the position of the purchaser because from a legal standpoint, if we cited in the various store people who were holding these boxes,

assuming they would refuse to assemble them, it might well be that this court of equity might say they had a possessory lien on them until the sixty cents was paid back, in all fairness to the store-keeper.

With that thought in mind, the Receiver negotiated with the purchaser and finally came up with the offer of compromise which totaled represents several thousand dollars less than the two items taken separately: One being the contested item with reference to the shortages in the inventory, forty per cent of \$19,000, which would total roughly in the neighborhood of \$5000 there. Then on your cases, set forth in the inventory on page 88A, if we were [5] to figure it out on a basis of the gross amount, we would have forty per cent of \$47,000 which is the total capitulation on that page, or if we could take it as a deposit per case we would have sixty cents for over twenty-five thousand cases. Either way you measure it, the amount is in excess of \$60,000.

The compromise as finally worked out on that item was that the purchase price would be reduced by the sum of \$17,500. In other words, lumping the two claims——

Mr. Katz: 18.5.

Mr. Gendel: That is correct, it would be \$18,500, leaving a balance to be paid upon the approval of this petition, if it is approved, in the sum of \$17,500. In other words, we lumped approximately \$16,000 on the cases and approximately \$5000 on the short-

ages and we reduced that by negotiation to an adjustment of \$18,500.

In connection with that adjustment, there was a discussion about accounts receivable. After having taken possession the Receiver found that the books and records of the Bankrupt, or the Debtor herein, whom we think will shortly be a bankrupt, were not properly kept. Offsets were not recorded in the regular books and records. As a matter of fact, they were not black books. I guess they were gray covered books showing offsets, but were not carried in the regular books, and the only records were \$19,000 of offsets against a gross amount of \$72,000 worth of accounts receivable. So we thought we had something [6] in the way of accounts receivable, but upon discovering the books and checking the matters further, it appeared that the practical value of the accounts which the California Associated Products Company had not collected up to the time of the commencement of the Debtor proceedings on the 28th of July had not been collected because there was an argument about some offset or claim. Therefore, the Receiver did not value those accounts receivable in excess of approximately \$3000 in his opinion.

After some discussion, the Wil-Rud Corporation indicated that they would prefer to buy or have the accounts receivable on the basis that many of those people would continue to be their customers, and they did not want the estate trying to collect whatever might be collectible by litigation or selling

them to some agency that might turn around and sue their accounts. Because of the uncertainty of the value of the accounts receivable, we did not feel it was advisable to enter into any outright sale as part of the compromise itself because there might be a feeling on the part of interested trade creditors that there had been some suppression of facts or values, and that there had not been an opportunity for every one to bid openly on the accounts which on the face look as if they would bring maybe fifty or sixty thousand dollars if they didn't know about the offsets. We therefore brought on a petition for a return of sale. And as I said [7] before, Your Honor, we have two things before the Court this morning: The Wil-Rud Corporation has offered \$3500 for the accounts receivable, as per Mr. Yates' list.

Mr. Yates: I am sorry I didn't bring the list.

Mr. Gendel: You don't have your list with you, either?

Mr. Yates: He has the master list, but I knew the figures.

Mr. Gendel: The gross amount on the accounts receivable was originally \$72,000, with acknowledged offsets, reducing it by \$19,000. We have reserved from those accounts receivable the claims of the estate against Messrs. Thompson, Green and Tanner and the Pacific Associated Products, California Marmalade, and also the Loma Linda account. All of the other accounts receivable which the estate now owns and which are included would

be encompassed in this proposed offer of sale. Actually the estate then, as far as liquidation is concerned, would be reduced to the particular accounts which have been reserved, and any action that might be brought against the individuals with whom we have reserved those accounts.

That is the status of the two items before Your Honor this morning. I understand there are some objections to the proposed sale.

The Referee: Let me see if I understand you. The bid was \$161,000.

Mr. Gendel: Yes, Your Honor. [8]

The Referee: You propose now to reduce that by \$18,500, is that correct?

Mr. Gendel: That is correct.

The Referee: That would leave \$142,500.

Mr. Katz: \$143,000.

Mr. Gendel: \$142,500, leaving a balance of \$17,500.

Mr. Katz: We paid \$125,000 on account, Your Honor. The order confirming the sale provides that we are not to pay until we get delivery of the assets.

The Referee: It is proposed to pay in addition to that the balance. You have paid \$125,000, you say?

Mr. Katz: That is right, Your Honor. We will pay the additional \$17,500 today.

The Referee: Plus \$3500 for the accounts receivable.

Mr. Katz: If there is any feeling on the part of anybody about the accounts receivable, candidly,

we are not so interested in them; they are a burden to us. But we will take them. If anybody else wants to pay an additional amount for them they can have them. Frankly, it is all right with us.

The Referee: What are the objections?

Mr. Levinson: Will the Receiver offer any testimony in support of the petition to compromise?

The Referee: I don't know. What type of testimony do you think should be introduced?

Mr. Levinson: I would like to hear some testimony with [9] regard to deposits, something more than Mr. Gendel's statement.

The Referee: Have you any person here who knows from firsthand knowledge about the people who put up sixty cents a case?

Mr. Gendel: Mr. Yates might be able to help us on that.

The Referee: Very well. Come forward, Mr. Yates.

(Witness sworn.)

Here is your witness, gentlemen.

RALPH J. YATES

called as a witness on behalf of the Trustee, having been first duly sworn, testified as follows:

Direct Examination

By Mr. Gendel:

Q. What is your name, please?

A. Ralph Yates.

(Testimony of Ralph J. Yates.)

Q. Are you connected with Mr. Lynch, the Receiver in the operation of this estate?

A. I was by claim and order of the court.

Q. In what capacity did you act?

A. I made an investigation of the books and records and I prepared operating statements. I attempted to assist creditors and Mr. Lynch and the Court in any manner that [10] I could.

Q. Mr. Yates, you have heard the question asked with reference to the deposits on the wooden cases. Will you tell us what you found with reference to the books and records?

Mr. Katz: You refer to them as wooden cases. It is the deposits on the wooden cases and the twenty-four bottles in the cases.

Mr. Gendel: Yes.

Q. With reference to the wooden cases and the twenty-four bottles in each of the wooden cases, what did you find when you investigated the books and records?

A. May I refer to the inventory, please? This inventory was taken as of July 28. On page 88-A there appears an item representing 25,807 wooden cases and bottles. In addition to that, there were 74,640 root beer bottles, 634,708 root beer bottles. This item was set forth as alleged to be in the vicinity or territory of Los Angeles, California.

That item was estimated by the deposits that were totaled from the cards that they had out there

(Testimony of Ralph J. Yates.)

representing cases outstanding in the territory on which there was a deposit of sixty cents a case.

Apparently no issue is being made of the 74,000 and the 634,000 root beer bottles. Mr. Katz overlooked that, apparently. But on the 26,000 wood shells and [11] bottles, there is a liability of sixty cents on those which would run over \$16,000. On the basis of forty cents on the shortage there would be an adjustment of \$18,000 coming to Mr. Katz; and on the 20,000 shortage that has been ruled on before there would be another \$8000, or \$28,500. I understand he is willing to compromise for \$18,500 and we are making \$10,000 on that matter.

Q. My question, Mr. Yates, was primarily directed to——

Mr. Levinson: I ask that all be stricken, if Your Honor please, as not responsive to the question.

The Referee: No, it won't be stricken. We will hear the whole story. We don't strike much over here. We will hear the whole story.

Mr. Levinson: All right, Your Honor.

Q. (By Mr. Gendel): My question was directed for the moment as to how you ascertained to your own satisfaction that sixty cents per shell, as you described it, for over 25,000 shells had actually been paid over to the California Associated Products Company prior to the commencement of the debtor proceedings by the various people who had possession of the cases or shells.

(Testimony of Ralph J. Yates.)

Mr. Levinson: Just a moment. That assumes that he did ascertain.

The Referee: Objection overruled. I will hear what the facts are, regardless of technicalities. You may answer. [12]

The Witness: Here is how I ascertained it. Mr. Brill, the agent and representative of the Creditors Committee, went through the list with the inventory men, and with Mr. Tanner, and tied in with the deposit control that Mr. Tanner had, and in conjunction with these cards that they had in the offices, and on that basis they estimated the outstanding cases and shells.

Q. (By Mr. Gendel): Did you yourself see these cards? A. Yes, I saw the cards.

Q. Were there any notations on the cards reflecting the receipt of sixty cents per shell?

A. Yes.

Q. Where are those cards now?

A. They are in the office.

Q. Was there any separate books other than regular books of entry of the corporation which indicated the receipt of the moneys?

A. Not identifying these particular customers that they had a general control which as it set forth here alleged and estimated and would be very difficult for any one to reconcile.

Q. By checking the regular books and records you could not tell where the money came from or that it was to be applied on these so-called deposits, is that right? A. No.

(Testimony of Ralph J. Yates.)

Q. It was only by checking back through these special [13] what they meant, is that right?

A. That is right?

Q. That check was made after Wil-Run Corporation complained that the retail men wanted their sixty cents per shell and they wanted to pick them up?

A. No. That check was made prior to that and is set forth in an inventory here. This figure is nothing but an estimated figure on bottles that are alleged to be in the vicinity of Los Angeles.

Q. Is there anything in the inventory which reflects that these shells are subject to sixty cents per case?

A. No, there isn't.

Q. You have examined the whole inventory, have you?

A. That is correct.

Q. That obligation is not set forth there at all, is it?

A. That is correct.

Mr. Gendel: That is all.

Cross-Examination

By Mr. Levinson:

Q. Mr. Yates, what do you know of your own knowledge as to the number of cases that are outstanding in the hands of distributors in the vicinity of Los Angeles or the City of Los Angeles? [14]

A. Of my own knowledge I don't know the exact amount.

Q. Did you assist Mr. Brill or Mr. Tanner in

(Testimony of Ralph J. Yates.)

any way in ascertaining the number of cases which were in this vicinity or in the city?

A. No. Unfortunately, this inventory was taken about forty days before I arrived on the scene.

Q. All you know is what you heard from some one else, is that right?

A. What I heard and what I tried to verify in checking back.

Q. What were you able to verify?

A. I couldn't reconcile this figure.

Q. Did you attempt to reconcile it?

A. I did.

Q. As far as you are concerned, it is somebody's guess?

A. As far as I am concerned, it is somebody's guess, and it appears to be from my examination substantially correct.

Q. On what basis, Mr. Yates? Upon what do you form the conclusion that it is substantially correct?

A. Well, I ran a tape on these so-called special cards and I accepted Tanner's deposit control figure to a certain extent. I figured it may be at least fifty per cent correct, so all I can do is just agree with the wording here: [15] They are estimated and alleged to be in this territory.

Q. The fifty per cent is merely an estimate on your part?

A. Based upon my checking his records.

Q. Have you contacted any of the distributors to find out how many cases are in their possession?

(Testimony of Ralph J. Yates.)

A. I have not.

Q. Have any distributors contacted you for the purpose of making any claims to the sixty cents on any cases?

A. They have returned cases and they have been credited with the sixty cents.

Q. You did not answer the question, Mr. Yates.

A. I probably didn't understand it.

Q. Have any distributors contacted you?

A. Personally?

Q. Yes. A. No.

Q. Do you know of any written agreement between any person in possession of any of these bottles or cases in reference to the sixty cents to be returned? A. I know of the practice.

Q. No. Please answer the question. Do you know of any written agreement?

A. No, other than the invoice itself.

Q. Where is the invoice to any of these people?

A. When the cases are delivered the sixty cents is [16] charged on the bill and if any cases are returned they are credited.

Q. Have you any bills or copies of bills?

A. Oh, yes, all of them.

Q. Where are they? A. In the office.

Mr. Levinson: I wonder if we could have them, Your Honor. I think they are very, very vital because there is a question as to whether or not these distributors have a lien.

The Witness: There are about four cabinets of them.

(Testimony of Ralph J. Yates.)

Q. (By Mr. Levinson): They are practically all alike, aren't they? A. Practically.

Q. I wonder if we could get some samples to see what they are like?

A. I am sure we can get you some.

Q. When the cases are delivered to the distributors the distributors charge so much for the cases themselves, is that right, for the number of bottles in the case? A. That is correct, plus deposit.

Q. Plus sixty cents? A. That is correct.

Q. Is there any indication on the invoice as to what the sixty cents is for? A. Yes. [17]

Q. What does it say, do you know?

A. So many cases at sixty cents a case.

Q. That is all it says on the invoices?

A. That is it, something like that.

Q. What?

A. I am not certain of the wording. I know the unit is multiplied by sixty cents.

Q. Is there any written statement anywhere to the effect that the distributor who paid the sixty cents has a lien on the case or the bottles in the case for the sixty cents?

A. I am not qualified to answer whether there is a lien.

Q. No. Is there any written statement. That is all I am asking. A. No, not that I know of.

Q. In other words, so far as you know, the only thing in writing any place is what appears on the invoice? A. And on the boxes.

(Testimony of Ralph J. Yates.)

Q. Do you know what the exact wording is on the boxes? A. I don't remember.

Q. Is the wording the same on all of the boxes?

A. I believe so.

Q. How can we get hold of one of the boxes to see what the wording is? [18]

A. I imagine bring one in.

Q. Do you know whether or not any of these distributors have filed a claim in court with the Referee in Bankruptcy for the sixty cents on any of the cases in their possession or that were in their possession?

A. Not that I know of. None that I know of.

Q. Do you know how many such distributors have those claims?

A. Well, the distributors take care of their own cases and bottles. You mean the customers?

Q. The customers, yes. How many such customers have such claims—retailers, we will call them. I have been calling them distributors.

A. Well, let's see. Oh, three or four hundred customers on the books.

Q. Have you checked to see how many customers have such claims?

A. None have filed any claims.

Q. That was not my question. Have you checked with them to see how many of them have such claims? A. No, I haven't.

Q. You have not checked with any of them to see what the amount of their claims are?

A. No. I also understand that in this arrange-

(Testimony of Ralph J. Yates.)

ment the Wil-Rud Company are to assume all bottle claims.

Q. No one knows how many claims there are or what the [19] number of those claims are?

A. No.

Q. Is that right? A. That is right.

Q. Or the amount of the claims?

A. That is right.

Q. But the Wil-Rud Company, I understand, are to relieve the Receiver of any liability on those claims, but no one knows what the amount of those claims is, is that correct?

A. Not the exact amount, no.

Q. Or the number of those claims?

A. That is correct.

Q. So far as that is concerned, both as far as the Receiver is concerned and the Wil-Rud Corporation is concerned, that is merely a cat in the bag proposition, is that true?

A. That is true. However, there is one thing that may help you. The Receiver sold to Wil-Rud \$48,000 worth of assets consisting of bottles and shells.

Q. That is merely your conclusion, isn't it, Mr. Yates? A. No, it is on the inventory there.

Q. That is on the assumption that the Receiver sold on the basis of the inventory instead of as of October 15, isn't that true?

Mr. Katz: The Court already so ruled. [20]

Mr. Levinson: I think not.

(Testimony of Ralph J. Yates.)

The Witness: That is up to the Court. I am not qualified to answer that.

Mr. Katz: There was a hearing, Mr. Levinson, at which the Court so ruled.

Mr. Levinson: I was present, but I didn't think any order was entered.

Mr. Katz: We have tried to adjust this pursuant to the Court's indication.

Mr. Levinson: There was no order entered.

The Referee: I wish you would bear in mind, gentlemen, that I am not going to let anybody buy something in this court and then pay for something he doesn't get.

Mr. Levinson: I quite agree with Your Honor in that regard. No one should have to pay for anything they don't get. * * *

Q. Mr. Yates, who paid the sixty cents, the customer or the distributor, do you know?

A. The customer put up the deposit when they were delivered.

Q. To whom? A. To the store.

Q. To the store? A. Yes, the retailer.

Q. You mean the consumer?

A. The retailer. [21]

Q. To whom did the retailer pay sixty cents?

A. To the driver, if it was a cash sale, and if it wasn't a cash sale——

Q. Whose driver would that be, the distributor's driver? A. No, the bankrupt's driver.

Q. The bankrupt's driver?

(Testimony of Ralph J. Yates.)

A. Or the debtor's driver.

Q. Do you know what the amount of those sixty cent pieces is? A. Roughly, yes.

Q. Well, only by this estimate, is that right?

A. That is right.

Mr. Levinson: That is all.

Mr. Lutz: May I ask Mr. Yates a question?

The Referee: Yes. Whom do you represent?

Mr. Lutz: Victor Kramer. I am Hugh Lutz.

The Referee: Go right ahead.

Cross-Examination

By Mr. Lutz:

Q. Mr. Yates, can you tell us of these sixty cent pieces the amount paid? What amounts were cash and what amounts were credit shown on these accounts receivable item 2 in this notice?

A. Well, the accounts receivable consist principally [22] of the California Associated Products accounts receivable and that represents claims—they were offset by claims and credits issued, and subsequently erased from the books. It represents spoiled merchandise. That is practically all of the accounts receivable, the major portion. The accounts receivable that are collectible are a few items that existed during the Receiver's operation and very, very little collectible prior to that time.

Q. I believe Mr. Gendel stated there were \$72,000 of accounts receivable? A. Roughly, yes.

Q. Of which he said \$19,500 he knew were no good?

(Testimony of Ralph J. Yates.)

A. No. They already had \$19,000 worth of credit balances entered on the books.

Q. That should have been charged against the seventy-two? A. That is right.

Q. Reducing the amount?

A. That is right.

Q. That makes it practically \$52,000?

A. That is right.

Q. Of that \$52,000 what part of it is not retained accounts such as Messrs. Thompson, Green and Tanner, and so forth, as shown in the notice, paragraph 2?

A. I would say offhand \$25,000 belongs to the bank of America. [23]

Q. Then would you say \$27,000 might represent accounts receivable from retailers or something like that, retailers and others?

A. Throughout the United States, yes. I believe that we have on record claims for more than half of them which they have already complained about, not only paying their bills, but they want a check for the credit balance due on them.

Q. What credit balances are you referring to, bottles or what?

A. Everything, bottles and juice. What happened is this. When they were preparing this petition under Chapter XI apparently—I don't know, I wouldn't say that, but they just erased, oh, about thirty or forty thousand of credit they had previously given to customers, and just increased their accounts receivable control.

(Testimony of Ralph J. Yates.)

Q. Getting back to my question. Have you any idea how much of these accounts receivable represent items of the charges on these shells?

A. Very little of it.

Q. Can you make an estimate?

A. Yes. I wouldn't say over \$500.

Q. That is your best opinion?

A. That really is.

Q. Of the accounts receivable only \$500 represent deposits? [24]

A. That is right, and I think I am very conservative.

Q. Did you make any summation of what you considered cash that was paid on these deposits as opposed to credit that was given——

A. No, I didn't.

Q. ——or debit that was entered?

A. No, I didn't, but when I say \$500 I am over-estimating it.

Q. Was any such estimate made by any one for the Receiver or for the purchasing corporation?

A. No. With the condition of the books you couldn't possibly break that down. You see, you had a funny situation. They started off with three partnerships and they dug up another partnership due to the OPA situation, and they wound up with three corporations. You had several sets of books to deal with. If they were kept properly it would be rather difficult to identify the amount of deposits of each individual customer. We were dealing probably

(Testimony of Ralph J. Yates.)

with a turnover of twelve or fifteen hundred customers.

Q. I understand you are referring to cards that were down in the office of the debtor or bankrupt. It was these cards alone that gave the information?

A. No. These cards give you a clue as to where the bottles were located. They were posted on the cards by the [25] telephone operator. There was no unit or dollar bill control against it.

Q. Was there any entry on the card to show whether it was credit or cash?

A. No, it was supposed to show where the bottles in the territory were located, the number of cases and bottles. In so far as that information is concerned, your smallest item in accounts receivable is the Yankee Doodle Root Beer Bottling Company and the accounts receivable involved there. I don't believe you have all told \$2000 worth of collectibles. The offer that Wil-Rud made was \$3500, which in their opinion was for the good will. In other words, if Mr. Lynch would call up the customers and bring them in and hound them for money, they may lose a customer. They all have some kind of a grievance. They all have some kind of a claim.

Q. I have no quarrel with that point. I am interested in what entry was made to show the amount of cash and the amount of credit or debit on these bottles.

A. It wasn't identified and you have no detail to support it.

Q. Have you any list of retailers who did busi-

(Testimony of Ralph J. Yates.)

ness with the company which would show who paid cash and who had an entry made?

A. To the best of my knowledge there hasn't been any inquiry made as to who paid cash and who were charged, but the present accounts receivable uses that as a basis. [26] When I say there isn't over \$500, as far as I know, outstanding, that is very reasonable.

Q. Referring to these cards and the names entered thereon, has any tape been run as against those cards and the accounts receivable to show how many persons on the accounts receivable are also persons who hold bottles?

A. Yes, sir, there was a tape made.

Q. Do you have that?

A. There was a tape made at that time. The tape was way in excess of \$25,000. The figures used had to be disregarded because the condition of the books was such that you couldn't go by the books. You couldn't go by them.

Q. We are referring to these little gray cards.

A. Yes.

Q. I believe you testified you could rely on them to some extent, at least to fifty per cent?

A. To some extent, yes. I would say fifty per cent would bring this alleged estimate substantially correct.

Q. As to those \$12,500 entries then, is there any relationship in your mind between those and the accounts receivable as to the parties involved?

(Testimony of Ralph J. Yates.)

A. No, I wouldn't say so. I believe there is a relationship, but I don't want to be bound by it. As a matter of fact, I often wonder whether this fellow Tanner used an Ouija Board when he got up some of these figures.

Q. What I am trying to get at, Mr. Yates, were the [27] names of these tneries in the gray books checked against the accounts receivable?

A. The names?

Q. Yes. A. Oh, yes.

Q. How many of them are there in the gray books and how many were also in the accounts payable?

A. In the gray book Mr. Gendel referred to I think are claims or credits that certain creditors are claiming against CAP and Yankee Doodle Root Beer Bottling Company, and they haven't as yet been entered into the books of the Debtor.

Q. I said gray book, but I really meant these cards wherein there were entered the sixty cent items.

A. On the cards no sixty cents were entered. They had the unit down there. They shipped one hundred cases of root beer to Ralph's place.

Q. Were those names checked against the accounts receivable?

A. The cards were made from the accounts receivable book. All we know is they were the same names, the same accounts, but the card was the statistical card and was supposed to show where the boxes were located.

(Testimony of Ralph J. Yates.)

Q. Are any of the accounts receivable that are being sold persons who are claiming money as deposits under the sixty cent per shell? [28]

A. No, no one.

Mr. Levinson: That is all. May there be enumerated by reference the order approving and confirming the sale signed by the Court and dated October 22, 1947?

The Referee: That is part of my record. It is already enumerated.

Mr. Levinson: In this particular proceeding?

The Referee: We take judicial cognizance of every official file here.

Mr. Levinson: Very well, Your Honor.

Mr. Katz: May I ask a question?

Mr. Levinson: Are you appearing on behalf of a creditor here, counsel?

Mr. Katz: I am appearing on behalf of the Wil-Rud Corporation.

The Referee: He has an interest in the matter.

Mr. Katz: I am interested in the compromise. I don't represent any creditors. I represent the purchaser, unless the purchaser becomes a creditor by reason of these proceedings.

The Referee: Go ahead and ask any question you want. Anybody here can ask any question they want. This is an open forum. We won't have any gag rule here. [29]

(Testimony of Ralph J. Yates.)

Cross-Examination

By Mr. Katz:

Q. Mr. Yates, on page 88-A of the exhibit the total of these bottles on the inventory ran some \$47,976.29, is that right? A. That is correct.

Q. None of that item on page 88-A has been delivered to the purchaser, is that correct?

A. I didn't check it out, but I believe that is what the purchaser is contending.

Q. You haven't any record of any delivery of that to the purchaser? A. I have none.

Q. You say that a part of that item of \$47,976.29 consists of some 25,807 wood shells holding twenty-four cases each, is that right? A. Yes, sir.

Q. You then ran a tape in an effort to verify whether there were actually 25,807 cases out or more, and your tape indicated that the 25,807 figure was about fifty per cent of what was actually outstanding in cases, is that right?

A. I have no idea what was actually outstanding, but it was fifty per cent of the so-called records they had there, and those records,—I checked them about forty days after this inventory had been taken. [30]

Q. Yes, and when you checked them would you say from your own check the figure of 25,807 wood shells is a conservative estimate in so far as the estate is concerned?

A. Well, I would say I would assume it would be at least fifty per cent correct.

Q. On the basis that they were fifty per cent

(Testimony of Ralph J. Yates.)

correct, the purchaser here under the indicated ruling of the Court would be entitled to 25,807 shells holding twenty-four bottles each?

A. I don't know what you are entitled to. I would say that would be a substantially correct quantity.

Q. The quantity would be substantially correct?

A. Yes.

Q. Now, you say you were familiar with the practice concerning deposits on these shells. Will you tell us what that practice was?

A. After Mr. Lynch went in there I went out and installed a system and I followed along the same practice that they had been using prior to the petition in bankruptcy. When they would deliver one hundred cases of root beer to a customer they would charge the customer sixty cents for the cases and eighty cents for the product. Then if they were to get back fifty cases or take back 120 cases they would give credit. Then that difference between the charge and the credit, the driver would pick up the cash.

Q. For every shell, including twenty-four bottles delivered to the customer, the customer was charged and paid sixty cents, is that correct?

A. That is correct.

Q. When the customer turned back the case to the Debtor, the customer became entitled to the return at the rate of sixty cents per case for each case he returned to the Debtor, is that correct?

A. That is correct. The driver was instructed

(Testimony of Ralph J. Yates.)

to try to pick up as many cases as he could because they were short on cases and glasses.

Q. During the time the Receiver was operating the driver was instructed to give each customer who surrendered a case credit of sixty cents per case?

A. That is correct.

Q. That was paid immediately?

A. That is correct.

Q. You could not pick up a case from a customer unless the driver gave him the sixty cents?

A. That is correct.

Q. That was the practice which this Receiver continued, following the practice of the Debtor, is that correct?

A. That is correct.

Q. That practice was followed under the direction of Mr. Lynch and yourself in the operation of the business? [32]

A. Under the direction of Mr. Lynch. I was out there helping him.

Q. Were the officers of the Debtor corporation around there and were they familiar with that practice at the time?

A. Yes.

Q. These cases are not sold to the customer who buys the root beer?

A. That is correct.

Q. They are deposited with him?

A. That is correct.

Q. Actually the cases and the bottles are worth more than sixty cents?

A. About \$1.80.

Q. So that from the standpoint of the Debtor or the purchaser, he would be better off getting the cases than getting the sixty cents?

(Testimony of Ralph J. Yates.)

A. Unquestionably so.

Q. Let me see if I understand you, Mr. Yates. You would state to this Court, based upon your actual operation of the business and the practice which you, through Mr. Lynch, carried on, that each customer having one of these cases is entitled to get sixty cents before the Debtor can pick up that case from the customer?

A. That is correct. That is my understanding as to what the Wil-Rud Corporation is to do. They are to assume [33] that liability.

Q. And it is the practice which you followed while you were running this business?

A. While Mr. Lynch was running the business.

Q. And according to your best knowledge it is the practice the Debtor followed while it had the business?

A. That is correct.

Mr. Katz: That is all.

Recross-Examination

By Mr. Lutz:

Q. Did the Receiver, to your knowledge, ever pay sixty cents to any one for these cases?

A. Yes.

Q. In cash?

A. Yes—practically on every sale he made there was a return and he paid sixty cents.

Q. That was a credit?

A. That is the same thing.

Q. He exchanged the cases?

A. Yes.

Q. But you never had a bunch of cases delivered

(Testimony of Ralph J. Yates.)

to you without an order and paid sixty cents per case, did you? A. No.

Q. Was that all you were doing, like exchanging milk bottles? [34] A. That is right.

Q. The customer would put a bottle out and you would put another bottle in?

A. That is right. Of course, there would be a shrinkage. People would take the bottles home. I believe I was told by the bottling manager that it was a twelve time round trip through breakage and shrinkage.

Q. In other words, twelve times a round trip?

A. You lose your case.

Q. You would lose your case and bottles?

A. Yes.

Q. And there would be no claim against you?

A. That is right.

Q. The way the books were kept there was no method of reconciling that loss?

A. If proper books were maintained you could tie that in. You see, the books were kept on work sheets by the accountant. He would have his man come in every so often. Then they would prepare a balance sheet, an operating statement. It was a deal where they had clerks in the office and the books were maintained in the accountant's office on work sheets.

Q. Do you have any opinion as to what percentage of the shells in the inventory had disappeared by reason of the twelve times out rule?

(Testimony of Ralph J. Yates.)

A. I haven't any idea, but you could ascertain that. [35] It would be strictly a guess. You would take the purchases and tie them in with the remaining bottles and compare that with the sales.

Q. Do you know when the last purchase of bottles or shells was made at the company to replace its stock?

A. I think there was a substantial purchase made about thirty days before the petition was filed.

Mr. Lutz: That is all.

Recross-Examination

By Mr. Katz:

Q. My attention has been called by Mr. Wilder to the following legend on each case. I want to see if it checks with your recollection.

Do you not recall that each case contains this legend: "Deposit sixty cents," right on the face of the case?

A. As I stated to the gentleman here, I know sixty cents was marked, but as to the legend I don't know.

Q. Does sixty cents appear on each case?

A. Yes, I remember sixty cents, but I don't remember whether it is marked deposit or not.

Mr. Levinson: Will Your Honor grant a continuance to permit bringing in a sample case?

The Referee: I will give you a thirty-minute intermission. [36]

Mr. Levinson: Can you do it in thirty minutes?

Mr. Katz: Mr. Lynch is here. Wouldn't you accept his word?

(Testimony of Ralph J. Yates.)

Mr. Levinson: No, I wouldn't. The exact wording is important here.

The Referee: I will give you thirty minutes. I am not going to string this thing along.

Mr. Levinson: Will your Honor pass it? If your Honor is willing to do that, we can get a case in here and see exactly what it says.

The Referee: I think it is immaterial. You have heard the testimony that that was the practice. Everybody charges for cases and bottles. Whether it said deposit or advance or whatnot, I don't think makes a particle of difference. Any other questions of this witness?

Cross-Examination

By Mr. Gillin:

Q. On the accounts receivable item proposed to be sold for \$3500, is there any list of those accounts receivable in court, Mr. Yates?

A. Not in court. The Wil-Rud Corporation have that list. Unfortunately they failed to bring it in this morning. But your client, incidentally, is listed on that list.

Q. I appreciate that and that I know. What I wanted to find out is the exact amounts shown and these offsets. [37] I wanted to know if there was any such list here so that one might intelligently examine it.

A. There is a list and the Wil-Rud Corporation has that list.

(Testimony of Ralph J. Yates.)

Q. But there is none in the hands of the Receiver? A. Not at this time, no.

Q. Let me ask you something else then. I note that you stated the value of the accounts receivable of the Yankee Doodle Root Beer Company, which would be the company in effect which my clients would be shown as indebted to since their dealings were in root beer rather than the general corporate picture, were worth some \$2000. In making that statement, were you taking into account the fact, as it now turns out to be, that the Wil-Rud Corporation, assuming that they had these accounts receivable and having proceeded on the assumption that they would buy them, is expecting to receive the sum of approximately \$3000 from one of these accounts alone, to wit, my client the Yankee Doodle Root Beer Bottling Company of San Fernando Valley, Inc.?

A. No, sir. As I understand it, the Wil-Rud Corporation is buying whatever right, title and interest the Receiver had in accounts receivable as of the 22nd, I believe, of last month. It was pointed out at the time that there would probably be an offsetting claim of approximately \$10,000 against any claim. [38]

Q. Let me ask you this question, Mr. Yates. That claim, as it turns out now, and which has been since made of record, is \$32,500 and not \$10,000, representing the actual loss suffered. That is apart from cash loss suffered by the sale to my client of an asset which the Bankrupt did not own

(Testimony of Ralph J. Yates.)

but collected for. So that the actual loss suffered by my clients, through the machinations of this corporation, amounts to some \$32,500, and has now been fixed in that amount——

The Referee: Don't say that. It hasn't been fixed.

Mr. Gillin: Not by the Court.

The Referee: Don't make that statement. That is incorrect. You filed a claim.

Mr. Gillin: Fixed in accordance with my client's accounting, not in accordance with this Court.

The Referee: Say fixed in your client's mind.

Mr. Gillin: All right, your Honor.

Q. Now, Mr. Yates, proceeding on the assumption—whether it be \$10,000 or \$32,500—if these claims are sold, these accounts, you say they would be subject to the setoffs. Now, what I want to find out is, what happens to the setoffs over and above the amount of the claim?

A. I am not qualified to answer that question. That is a legal question. All I know, all Wil-Rud is buying in so far as your client is concerned is any equity he may have in your account, and Wil-Rud is not assuming any [39] deficiency or liability that may result as a result of the offset.

Q. That answers the question. To go one step further, if this accounting, among others which may be similarly situated, is still off, it is a fact, isn't it, that the Receiver or Trustee, if this thing be-

(Testimony of Ralph J. Yates.)

comes a regular bankruptcy, would then be left with a very substantial claim against it and would no longer be left with an item which could be used for a settlement or petition to compromise.

The Referee: I think you are getting into a legal question which this man is not qualified to answer. He is an accountant and not a lawyer.

Q. (By Mr. Gillin): Asking you directly from an accountant's standpoint, Mr. Yates, then there would still be left as a claim against the bankrupt estate a difference between that amount of setoff necessary to exactly equal the claim being sold and the amount of the setoff as it might ultimately be determined by the Court?

A. It is a matter of computation. Usually I believe those setoffs would become unsecured claims.

Q. That is right, against the estate?

A. That is correct, together with the others.

Mr. Gillin: That is all.

The Referee: Let's take a five-minute recess.

(A short recess at this point.) [40]

The Referee: Are you ready to resume?

Mr. Gendel: Is there anything further wanted of Mr. Yates by these various gentlemen? * * * Mr. Wilder, will you take the stand, please?

WOLF WILDER

called as a witness on behalf of the Receiver, having been first duly sworn, testified as follows:

Direct Examination

By Mr. Gendel:

Q. What is your true name, please?

A. Wolf Wilder.

Q. Your residence? A. Los Angeles.

Q. Are you connected with the Wil-Rud Corporation? A. I am the secretary.

Q. You are the "Wil" of Wil-Rud, are you?

A. That is correct.

Q. Have you been in active contact with the assets of the Debtor corporation taken over after October 15, 1947, by the Wil-Rud Corporation?

A. I have.

Q. Have you had any personal contact with this wooden shell problem? A. I have. [41]

Q. Have you examined any of the old invoices that were sent out by the California Associated Products or the Yankee Doodle subsidiaries prior to July 28?

A. I have. We are still using the same ones.

Q. You are using the same forms?

A. Yes.

Q. Can you tell us as closely as you recall verbatim the customary phraseology with reference to the so-called sixty cent problem?

Mr. Levinson: I object to that as not the best

(Testimony of Wolf Wilder.)

evidence. This is a very vital question, Your Honor. We should have the exact wordage.

The Referee: I don't think it makes any difference.

Mr. Levinson: I do, Your Honor, because if they have a lien then my attitude would be one thing. If the people put up sixty cents, that is one thing, but if not, that is another story.

The Referee: How could they have a lien?

Mr. Levinson: If Your Honor agrees that they have no lien that is enough as far as I am concerned.

The Referee: It is a deposit. It is a claim they would have.

Mr. Levinson: The Receiver on the other hand in his petition—may I have it, please? I loaned it to you, Mr. Gendel—he made a so-called statement that they have something in the nature of a lien or some kind of a claim, [42] and he set forth in his petition these words—my attitude might change entirely on this if I felt that these people who had sixty cents had a lien, and I think Mr. Steinmeyer is in the same position. Is that right, Mr. Steinmeyer? We represent about \$200,00 in creditors.

Mr. Katz: May I say this?

Mr. Levinson: Excuse me. Here is what the Receiver says in his petition regarding the compromise.

The Referee: All right.

Mr. Levinson: (Reading) “. . . that the Debtor

(Testimony of Wolf Wilder.)

has taken deposits of sixty cents per case, and that said deposits are reflected by the fact that each of the customers having possession of the cases and bottles therein have a lien by virtue of the possession thereof until the sixty cents is repaid; . . .” Now that is an indication that the Receiver may think they have a lien. If Your Honor does not think they have a lien that is quite another story.

Mr. Katz: Let’s see what actually happened. Under this order here we are to get a certain number of cases. We would be much better off as far as we are concerned if the Receiver went out and got the cases and delivered them to us. We would get \$1.80 a case. But he can’t deliver the cases to us. What does it cost to go to each of the customers and say, “Surrender the case to me”? In the first place they will not do it because the truth of the matter is there is a possessory right. I don’t know whether you [43] would call it a pledge or what it is, but a person who has paid sixty cents as a deposit on these cases and who has possession of them would have what is pretty much like a situation in a bank. They have a banker’s lien.

The Referee: I don’t recall any section of the Lien Code that gives a man a lien on a box because he pays sixty cents on it. Can you cite me something?

Mr. Katz: Except that he has this right of possession to hold it until his right thereon is paid off. He has paid sixty cents for those cases.

(Testimony of Wolf Wilder.)

The Referee: As I understand it, liens are the creatures of statute.

Mr. Levinson: Correct, Your Honor.

Mr. Katz: And there is a lien dependent on possession.

The Referee: That is true if you have a blacksmith's shop or an automobile shop, but the statute specifically enumerates it.

Mr. Katz: But there is a common law right dependent on possession. There are a multitude of rights.

The Referee: There may be an offset right.

Mr. Katz: You couldn't compel this person, it seems to me, and if the estate can compel him, fine, let them go out and get the cases. We are not anxious to get the compromise, candidly, because the cases do us more good than the amount we are settling for. But looking at it from the practical standpoint of creditors for less than [44] sixty cents even pick up the boxes and deliver them to the buyer.

The Referee: I don't think you could.

Mr. Levinson: Your Honor, that makes vital the question of whether they have a lien by express written agreement. If that is true, that is one proposition. Otherwise, I feel as Your Honor does, they are nothing but common creditors to the extent of sixty cents.

Mr. Katz: How does that solve our problem? Just give us our cases.

(Testimony of Wolf Wilder.)

Mr. Levinson: There is some question as to what your proposition is.

The Referee: Do you object to this gentleman telling us what is on the boxes?

Mr. Levinson: I would like to have the exact written words.

The Referee: Objection overruled. He can tell us what he read a lot quicker than bringing a crate in here. What is the question?

Q. (By Mr. Gendel): I asked you to give us if you can verbatim the exact phraseology on the invoices, and then we will get to the shells.

A. The delivery slip or invoice gives the name of the firm, the Yankee Doodle Root Beer Company, and then the customer's name, and the word "fulls, medium or small," and then "empty, large, medium, small," and then spaces to [45] fill in the amount. "Charge customer for amount of fulls less the amount of empties returned," and the net amount to be paid in cash is to be charged.

Q. Have you seen any invoices, Mr. Wilder, which represented an original delivery of what you describe as fulls to a customer, a retail customer?

Mr. Katz: We are not talking about the trucker's slip that you described; we are talking about the invoice.

The Witness: The actual invoice? I can't say just what the wording is on the actual invoice sent out by the office.

Q. (By Mr. Gendel): What if anything can

(Testimony of Wolf Wilder.)

you tell us about the stamp on each of these shells?

A. There is a round circle with the deposit half-way around it and sixty cents burned in on the ends of each one of these shells. There is the word "deposit" and then 60 and the cent mark and a circle. That is the exact wording.

Q. That is branded into each of the shells?

A. That is correct.

Q. How long would it take to have somebody bring in one of the invoices or a sample?

A. We could have them here within thirty minutes.

The Referee: I am going to a Bar luncheon at noon. If you want to put this over until afternoon, all right.

Mr. Levinson: I cannot come this afternoon.

The Referee: I am sorry, but we are going right ahead. I will not defer these hearings any longer.

Mr. Levinson: You may dispose of it now, as far as I am concerned, Your Honor.

Mr. Katz: We are ready.

Q. (By Mr. Gendel): Mr. Wilder, have you yourself made any effort to ascertain how many shells were outstanding as of the time that you took over with the various customers that you inherited?

A. No, sir. I couldn't make any attempt to verify what shells were in the customers' possession.

Q. You have been operating the plant several months now? A. Three months.

Q. Three months, and you have nothing that

(Testimony of Wolf Wilder.)

you could give us in the way of factual information on how many shells have been found to be in the hands of customers? A. No, sir.

Q. Do you know whether or not there were approximately 25,000 shells outstanding in the hands of retail customers on October 15, 1947?

A. I would have no way of knowing.

Q. Have you attempted to reconcile the records of the Debtor corporation referred to by Mr. Yates?

A. We don't have them. We don't have the records. They are in the possession of the Receiver.

Q. You have not checked those records yourself?

A. Oh, no.

Mr. Katz: Mr. Rudolph handled that on the inventory.

Mr. Gendel: That is all.

Mr. Gillin: I would like to ask a question concerning the accounts receivable, Your Honor.

Cross-Examination

By Mr. Gillin:

Q. Is it not a fact approximately a week or ten days ago, undoubtedly subsequent to the time that you had some sort of a preliminary arrangement with Mr. Gendel as to the accounts receivable of which we have no list, but prior to this date, you instructed Mr. Katz to collect the sum of approximately \$3000 on——

Mr. Katz: We will object to that.

Mr. Gillen: Let me finish the question, please.

(Testimony of Wolf Wilder.)

The Referee: Go right ahead with your question.

Mr. Gillin: (Continuing) —to collect the sum of \$3000 on one of these accounts receivable, to wit, that against the Yankee Doodle Root Beer Bottling Company of San Fernando Valley, Inc.

Mr. Katz: We object to the question on the ground it is immaterial.

The Referee: I will let him answer the question. Do you know that, sir? [48]

The Witness: I told Mr. Katz that the Yankee Doodle of Glendale was in escrow and that there was money coming under the list of accounts receivable and to take such action as he saw fit.

Mr. Katz: And Mr. Katz told you that no claim could be presented until you became the purchaser, didn't he?

The Witness: That is correct.

Q. (By Mr. Gillin): Is it not a fact that when you were specifically questioned by Mr. William Lansburg, one of the former stockholders of Yankee Doodle Root Beer Bottling Company of San Fernando Valley, Inc., shortly after the incident I speak of, that you told him that Mr. Katz acted at your specific instruction?

A. Well, Mr. Katz told me we could file a claim.

Q. No. I am asking you if it is not a fact that you so informed Mr. Lansburg that Mr. Katz was acting under your specific direction?

A. I told him to take the matter up with Mr. Katz because I had nothing to do with it.

(Testimony of Wolf Wilder.)

Q. You did not tell him that you had requested Mr. Katz to proceed as he had with respect to this escrow?

A. I told him to refer the matter to Mr. Katz. I told him I didn't care to discuss the matter with him. I told him to contact Mr. Katz.

Mr. Gillin: All right. We will ask Mr. Katz further about that. [49]

The Referee: I am not concerned with that for the reason you say you have a claim of \$32,000 against somebody, a \$10,000 claim or at least a \$4500 claim for something that was sold to you. I am not going to let you ramble all over the lot and explore possible losses.

Mr. Katz: You don't contend you paid, do you?

Mr. Gillin: We do not.

Mr. Katz: All right, then.

Mr. Gillin: But I think I should have an opportunity for objecting to the sale of the accounts receivable.

The Referee: Let's hear it.

Mr. Gillin: The objection is on file, but I would like to summarize it. The situation very briefly is this. This bottler whom I represent, one of those franchised by the company, sustained a very serious financial loss because of the actions or lack thereof, of the company, the California Associated Products Company, a wholly owned subsidiary of the Yankee Doodle Root Beer Bottling Company. The losses which my client sustained as a result—I don't like

(Testimony of Wolf Wilder.)

to use the word defalcation, although it is certainly true under some circumstances, but certainly a failure to properly carry out their own commitments as to operations of their own business caused my clients some \$32,000, and there is a claim in that amount on file in this proceeding. Now, if these accounts receivable were sold for a total of \$3500, being some \$50,000 worth, and this account of \$3000 is sold with it, this situation will have resulted—whereas at the present moment there is in the hands of the Receiver and his attorney an offer by my client to pay to the Bankrupt the sum of \$250 and wipe out its claim for \$32,500, assuming that the Bankrupt wipes out this claim for \$3000, the end result of that offer will be that the estate will receive \$250 and will be absolved of a claim for \$32,500 on which a very substantial dividend would be paid, assuming all or any part of it is allowed by this court; but if these accounts receivable are now sold as proposed for \$3500, this estate will have to stand the expense of litigating or defending against the \$32,500 claim, and the result will be finally that considerable expense will be incurred that way, and in addition thereto, my clients may wind up with a substantial claim against the estate. I feel that the proper form in which to thrash out any differences and attempt to come to some settlement is here and not elsewhere.

Mr. Gendel: If Your Honor please, I would like to make this statement for the record. It is

(Testimony of Wolf Wilder.)

true that probably some time in October one claim was filed by the Yankee Doodle Root Beer Bottling Company of San Fernando Valley, Inc., the client of Mr. Gillin. That particular claim had not been called to our attention, nor was the administration of the estate in a status where we were considering objections to claims. After the proposed sale of accounts receivable was entered into, then Mr. Gillin became rather active in pressing the various claims and supplementing them. I have discussed the matter briefly with Mr. Lynch and I would suggest this: In view of the size of the claim of their client alone and considering the fact that there may be other persons in the same position, and the fact that we might be able to collect, say, \$2000 instead of the proposed \$3500 that is offered here, I think it might be advisable to withdraw the offer of sale of the accounts receivable from the consideration of the compromise. That would then leave to the Court and the purchaser the problem as to whether we should approve the compromise as submitted to the Court separate from the petition for the return of sale. In that way we might eliminate and prevent any hardship to any alleged debtors of the estate who might to some substantial extent end up being creditors, thereby saving for future unsecured creditors a bigger share of the dividend which might be payable, because even if one claim were allowed of approximately \$10,000 and we were to pay a thirty-five cent dividend ultimately, which we ap-

(Testimony of Wolf Wilder.)

proximate we may be able to pay, that one claim would be equivalent to the purchase price being offered. If we could work that out, the Receiver is still in a position with reference to the cases where it is the better part of discretion, in view of the Court's indicated ruling on the first matter so far submitted, and [52] that is on the shortages, that the compromise should be completed. We don't like it, but those are the circumstances. We have stated our position and it is now up to the Court and the other creditors. We do feel it might be advisable to all concerned, however, to withdraw the accounts receivable from the sale.

Mr. Lutz: Before leaving the question of the cases may I ask a few questions of the witness?

The Referee: Go ahead.

Cross-Examination

By Mr. Lutz:

Q. Mr. Wilder, has the Wil-Rud Corporation, for instance, when this sale was consummated, did it take possession of the plant of the California Associated Products on or about the sale date, October 15?

A. We took possession October 15.

Q. You went into the plant and started operation, is that correct? A. That is right.

Q. Have you been manufacturing and selling root beer and other similar products that the company was engaged in previously?

(Testimony of Wolf Wilder.)

A. Not myself personally, no.

Q. Well, the company. Has the corporation or the buyer been engaged in that? [53]

A. No.

Q. Has the plant been operated at all?

A. Now, wait a minute. Which company are you talking about?

Q. The Wil-Rud Corporation, the buyer.

A. The Wil-Rud Corporation was not in the bottling business before they took over this plant.

Q. Well, have they been in the bottling business since they took over the plant?

A. We are operating the plant.

Q. You are operating the plant. Have you been manufacturing and selling root beer since you took over the plant?

A. Yes, sir.

Q. Has that root beer been cased in shells and sent to distributors?

A. Yes, sir.

Q. How many cases have you manufactured since you took over in October?

A. Oh, I can't give you that figure.

Q. Approximately?

The Referee: How would that be material?

Mr. Katz: Yes, what difference would it make. He lost about \$10,000 a month.

Mr. Lutz: I think the question is material because if they manufactured root beer and sold it they had cases. [54]

The Referee: Undoubtedly they had cases.

(Testimony of Wolf Wilder.)

The Witness: There were quite a few thousand cases on hand in the inventory elsewhere.

Q. (By Mr. Lutz): What have you done in selling your root beer? Have you delivered it in cases and picked up other cases?

A. That is right.

Q. How many cases have you sold since the Wil-Rud Corporation took over the plant?

A. It would be pretty hard to say offhand.

Q. What is your best estimate?

A. Oh, about five hundred a week.

Q. That is over a period of a little over three months, is that right? A. About three months.

Mr. Lutz: That is all.

The Referee: Any other questions?

Mr. Gillin: Yes, Your Honor. I would like to supplement what Mr. —

The Referee: Your matter is pretty well settled if these accounts are withdrawn, counsel.

Mr. Gillin: If you have withdrawn them I have nothing further to say.

The Referee: Then why gild the lily? You don't have to paint it; it is already white.

Mr. Gillin: Very well, Your Honor. [55]

Mr. Katz: That is all.

The Referee: Has anybody else anything to say? All right, I will approve this.

Mr. Levinson: May we have an expression from counsel representing the creditors as to whether or

not they are in favor or against the compromise, just as a matter of record?

The Referee: Yes, sir. I would be glad to hear anybody's opinion on it.

Mr. Levinson: I vote on behalf of my own claim and W. M. Yaffee & Co. against approval of the compromise.

Mr. Steinmeyer: As far as the Bank of America is concerned, if the Court please, we object to the compromise because I think from the evidence introduced here and the testimony taken, there is no showing that the purchaser at this sale is entitled to any protection on account of the purchase price by reason of any of the matters that are set forth in the petition or which have been introduced in evidence. The sale was made of the property as is and where it is wherever situated. The Debtor took possession of the stuff. He has apparently been able to get possession of a large number of cases in the hands of distributors. There is no showing that there is any lien or encumbrance, to indicate that there was not a compliance with the sale free and clear of lien. The contract of the purchaser was to buy the property wherever situated and that is what [56] is what they did. I see no basis for any reduction in the purchase price from a solvent purchaser on a sale that was confirmed after extensive competitive bidding by reason of any of the facts that have been brought out here. I wish to call the Court's attention to the fact that at the time of the

sale in this room there was considerable discussion as to what the assets were so the purchaser, not only this purchaser, but also the other bidders had had an opportunity to examine the plant and the inventory. They were already aware that the property was being sold in its then condition. I think there is no basis for any argument that they did not know what they were buying or did not get what they thought they were buying.

Mr. Lutz: On behalf of Victor Kramer I would object to it.

Mr. Cotter: On behalf of the F. W. Boltz Corporation, we object to the compromise because the compromise depends on the question as to whether or not these deposits were a lien upon the cases which were sold and whether or not possession could be given to the buyer because of it. If the compromise were based on the as is question alone, that would not be involved in our present objection. We object very strenuously to it on the ground there is no lien and on the basis of the testimony taken this morning that that is one of the primary reasons for sustaining the compromise if the compromise were to be sustained. [57]

Mr. Gillin: On behalf of the Yankee Doodle Root Beer Bottling Company of San Fernando Valley, Inc., we object only to that portion of the proposal relating to the accounts receivable.

The Referee: That is practically out of the window now.

Mr. Gillin: I did not hear Mr. Katz say he agreed to withdraw it.

The Referee: I think this compromise is fair. I don't think any man ought to be required to pay for anything he doesn't get. He had a right to rely upon the inventory prepared. So I will approve this compromise.

As to the accounts receivable, they will be withdrawn from the sale and the Receiver will try to do what he can to collect on them.

These books were kept by a man named Tanner in a way that nobody could tell what the situation was.

Mr. Katz: I wonder, in the light of what appears to be an exception, if I could get one question in from Mr. Rudolph so that the record is clear.

Mr. Levinson: If it is necessary to note an exception I will do so.

The Referee: You don't need to.

Mr. Levinson: On behalf of my client and myself, but I don't think it is necessary.

The Referee: You have ten days in which to review.

Mr. Levinson: May a copy of the proposed order be [58] served upon me?

Mr. Steinmeyer: I would like to see a copy of it before it is signed.

The Referee: All right.

Mr. Katz: I had assumed this was stipulated to in my discussion earlier with Mr. Gendel.

(Mr. Rudolph approaches the witness stand.)

Mr. Levinson: I understood the matter was closed. His Honor made a ruling favorable to you, Mr. Katz.

A Voice: Has Mr. Rudolph been sworn?

Mr. Katz: I wanted to have the record clear on one matter which Mr. Gendel stipulated to, but I think the record should be cleared up.

The Referee: If you intend to review me I want to be as safe as I can, gentlemen.

(Mr. Rudolph sworn.)

Mr. Katz: Mr. Gendel, I have here what is a copy of the inventory, which the earlier hearing in this matter shows was delivered by a representative of Mr. Lynch to Mr. Rudolph before the bid was made. Will you stipulate this is a copy of the inventory delivered to Mr. Rudolph before he made the bid upon the assets by a representative of the Receiver?

Mr. Gendel: Mr. Katz, I will stipulate that the Receiver had an inventory out at the premises and that Mr. [59] Rudolph looked at the inventory, and that page 88-A contains what is written thereon.

Mr. Katz: All right.

Mr. Levinson: I object, Your Honor, to any testimony being taken by this party here because he is not a party to the proceedings. This is a proceeding for the Court and the creditors to pass on.

The Referee: But this man is a purchaser.

Mr. Levinson: It doesn't make any difference, Your Honor.

The Referee: I think it does.

Mr. Levinson: That is all I have to say as far as this matter is concerned.

The Referee: All right, sir. Proceed, Mr. Katz.

SAM RUDOLPH

called as a witness, having been first duly sworn, testified as follows:

Direct Examination

By Mr. Katz:

Q. Mr. Rudolph, is this a counterpart of the instrument you were shown by the Receiver prior to the time you made the bid? A. Yes, sir.

Q. Did you examine page 88-A?

A. I did, sir. [60]

Q. That shows items totaling some \$47,976.29, consisting of bottles and cases, is that right?

A. That is right, sir.

Q. Has the Receiver ever made delivery to you of any of the items listed on page 88-A?

A. He has not, sir.

Mr. Katz: May I offer page 88-A, if the Court please?

Mr. Gendel: For the purpose of the record, couldn't we read page 88-A in? It might be clearer if it is included in the transcript.

Mr. Katz: We will stipulate the reporter may make a copy of page 88-A of the inventory and give it a deferred exhibit number.

Mr. Gendel: So stipulated.

Mr. Katz: Is that agreeable to the Court?

The Referee: Yes, sir.

Mr. Katz: That is all.

Mr. Gendel: No questions.

The Referee: Very well, that is all, gentlemen.

(Which was all the evidence offered and received at the time and place aforesaid. The page referred to, 88-A, was copied and is appended hereto and marked Exhibit 1.) [61]

EXHIBIT 1

Copy of Page 88-A of Inventory Bottles and Cases

Alleged to be in the vicinity or territory of Los Angeles, California.

74,640 root beer bottles 7 oz. 518.13 Gross

5.80 \$ 3,006.33

634,708 root beer bottles 10 oz. Gross 6.11 26,930.87

25,807 wood shells (hold 24 each) each

.699 18,039.09

Above figures received from Mr. Leo Brill on August 13, 1947. [62]

State of California,
County of Los Angeles—ss.

I, Byron Oyler, Official Court Reporter, hereby certify that the foregoing sixty-two (62) pages compromise a true and correct transcript of my

shorthand notes of the testimony given in the above entitled matter.

Dated this fifth day of February, 1948.

/s/ BYRON OYLER,

Official Court Reporter.

[Endorsed]: Filed April 13, 1948.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

I, Edmund L. Smith, Clerk of the United States District Court for the Southern District of California, do hereby certify that the foregoing pages numbered from 1 to 71, inclusive, contain the original Petition Under Chapter XI of the Bankruptcy Act; Approval of Debtor's Petition and Order of Reference Under Section 322 of the Bankruptcy Act; Referee's Certificate on Review; Order Confirming and Approving Sale; Petition for Order to Show Cause re: Wil-Rud Corporation Sale; Order to Show Cause re Wil-Rud Corporation Sale; Petition for Leave to Compromise re Wil-Rud Corporation Sale; Notice of Hearing on Petition to Compromise and Sale of Accounts Receivable; Findings of Fact, Conclusions of Law and Order of Referee Approving Petition for Leave to Compromise Wil-Rud Corporation Sale; Petition for Review of Referee's Order Dated February 26, 1948 by Judge; Memorandum Opinion; Notice of Appeal filed January 14, 1949; Bond for Costs on Appeal filed January 14,

1949; Designation of Record on Appeal filed February 2, 1949; Findings of Fact, Conclusions of Law and Order Granting Petition for Review and Reversing Order of Referee Approving Compromise; Notice of Appeal filed June 21, 1949; Bond for Costs on Appeal filed June 21, 1948; and Designation of Record on Appeal filed June 30, 1949 and full, true and correct copy of Minute Order Entered December 16, 1948 which, together with copy of reporter's transcript of proceedings on October 15, 1947, November 7, 1947 and January 29, 1948, and original petitioner's exhibits Nos. 1 and 2 at the hearing held November 7, 1947, transmitted herewith, constitute the record on appeal to the United States Court of Appeals for the Ninth Circuit.

I further certify that my fees for preparing and certifying the foregoing record amount to \$2.00 which sum has been paid to me by appellant.

Witness my hand and the seal of said District Court this 28 day of July, A.D. 1949.

EDMUND L. SMITH,
Clerk.

[Seal] By /s/ THEODORE HOCKE,
Chief Deputy.

[Endorsed]: No. 12309. United States Court of Appeals for the Ninth Circuit. Wil-Rud Corporation, Appellant, vs. E. A. Lynch, Receiver and Trustee of the Estate of California Associated Products Co., Aaron Levinson, Victor Kramer, Bank of America National Trust and Savings Association, F. W. Boltz Corp., and Leo Brill, Appellees. Transcript of Record. In Two Volumes. Vol. I. Appeals from the United States District Court for the Southern District Court for the Southern District of California, Central Division.

Filed July 29, 1949.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the
Ninth Circuit.

United States Court of Appeals
For the Ninth Circuit

No. 12309

In the Matter of

CALIFORNIA ASSOCIATED PRODUCTS CO.,
a corporation, doing business as YANKEE
DOODLE ROOT BEER BOTTLING COM-
PANY,

Bankrupt.

WIL-RUD CORPORATION,

Appellant,

vs.

E. A. LYNCH, et al.,

Appellees.

STATEMENT OF APPELLANT'S POINTS IN-
TENDED TO BE RELIED UPON ON APPEAL

To the Clerk of the Above Entitled Court, and to the Appellees and Petitioners for Review, Bank of America National Trust and Savings Association, Leo Brill, F. W. Boltz Corporation, a California Corporation, Victor Kramer, and Aaron Levinson, and to their respective counsel of record, and to E. A. Lynch, Receiver and Trustee in the Above Entitled Action, and to His Counsel of Record:

Pursuant to Rule 19, subdivision 6, of the Rules of this Court, Wil-Rud Corporation, a corporation, appellant herein, hereby states the points upon

which it intends to rely upon its appeal herein, taken from that certain Order of the District Court of the United States, Southern District of California, Central Division, granting the Petition for Review, and reversing the Order of Referee Approving Compromise, heretofore made, and entered on May 26, 1949, in Judgment Book 58, page 475, in the office of the Clerk of said District Court, reversing the Order of the Referee, dated February 26, 1948, upon the Petition for Review of Aaron Levinson, Bank of America, Leo Brill, F. W. Boltz Corporation, and Victor Kramer (hereinafter referred to as "Order"), as follows:

1. That the aforementioned Order is contrary to law.

2. That the aforementioned Order is contrary to the evidence in this case.

3. That the aforementioned Order is unsupported by the evidence in this case.

4. That the evidence is insufficient to justify and support said Order.

5. That the Findings of Facts made by the said District Court are contrary to the evidence in this case.

6. That the Findings of Facts are unsupported by the evidence in this case.

7. That the Conclusions of Law of the said District Court are contrary to law.

8. That the Conclusions of Law of said District Court are contrary to the evidence in this case.

9. That the Conclusions of Law of said District Court are unsupported by the evidence in this case.

10. That the said District Court exceeded its authority and jurisdiction upon review in making findings of fact upon issues and matters not before it upon the Petition for Review.

11. That the District Court erred in reversing the Order of the Referee Approving the Compromise between the Receiver and Appellant.

12. That the District Court erred in making its Findings of Facts, among other things, in the following particulars:

a. That Finding of Fact No. 2, in so far as it purports to find "That said inventory does not purport to be other than an inventory made as of July 28, 1947. That this fact was made known to all bidders. That at the time of the sale the said assets were offered 'as is' and without any warranty as to quantity or quality and without any reference to any inventory. That immediately after the confirmation of the sale, the assets so sold were delivered to the Wil-Rud Corporation." is contrary to the evidence in this case.

b. That the portion of Finding No. 2, set forth in subdivision "a" hereof, is unsupported by the evidence in this case.

c. That the aforementioned portion of Finding

No. 2, set forth in subdivision "a" hereof, is outside of any issues presented upon the Petition for a Leave to Compromise Controversy, and was not before the Referee upon said Petition, and therefore is in excess of the District Court's jurisdiction to make findings thereon upon review.

d. That Finding No. 4 is contrary to the evidence in this case.

e. That Finding No. 4 is unsupported by the evidence in this case.

f. That said Finding No. 4 is beyond the issues presented on the Petition to Compromise Controversy before the Referee, and therefore is in excess of the jurisdiction of the District Court on review.

g. That Finding No. 5 is contrary to the evidence in this case.

h. That Finding No. 5 is unsupported by the evidence in this case.

i. That said Finding No. 5 is beyond the issues presented on the Petition to Compromise Controversy before the Referee, and therefore is in excess of the jurisdiction of the District Court on review.

13. That the District Court erred in making its Conclusions of Law as follows:

a. That Conclusion of Law No. 2 is contrary to law.

b. That Conclusion of Law No. 2 is contrary to the evidence in this case.

c. That Conclusion of Law No. 2 is unsupported by the evidence in this case.

d. That Conclusion of Law No. 3 is contrary to law.

e. That Conclusion of Law No. 3 is contrary to the evidence in this case.

f. That Conclusion of Law No. 3 is unsupported by the evidence in this case.

g. That Conclusion of Law No. 4 is contrary to law.

h. That Conclusion of Law No. 4 is contrary to the evidence in this case.

i. That Conclusion of Law No. 4 is unsupported by the evidence in this case.

j. That Conclusion of Law No. 5 is contrary to law.

k. That Conclusion of Law No. 5 is contrary to the evidence in this case.

l. That Conclusion of Law No. 5 is unsupported by the evidence in this case.

14. That the aforementioned Conclusions of Law Nos. 3, 4 and 5 are, and each of them is, in excess of the jurisdiction of the District Court on review, in that they purport to determine issues not presented to, or before the Referee on the Petition to Compromise Controversy.

Dated this 12 day of September, 1949.

CHARLES J. KATZ.

By /s/ SAMPEL W. BLUM,

Attorneys for Appellant.

[Endorsed]: Filed Sept. 19, 1949.

[Title of Court of Appeals and Cause.]

STIPULATION IN LIEU OF PRINTING
PORTIONS OF RECORD

It Is Hereby Stipulated and Agreed, by and between the appellant, Wil-Rud Corporation, and the appellees, Bank of America, Leo Brill, F. W. Boltz Corporation, Victor Kramer, Aaron Levinson, and E. A. Lynch, by and through their respective counsel, that the following shall become a part of the record herein and considered upon this appeal; that the same shall become a part of the printed record herein in lieu of that portion of the record herein to which the same relates as follows:

1. That on July 29, 1947, a Petition for Plan of Arrangement under Chapter XI of the Bankruptcy Act was filed by California Associated Products Co., a corporation, doing business as Yankee Doodle Root Beer Bottling Company, as the then Debtor, in the District Court of the United States, Southern District of California, Central Division, in that certain proceeding entitled, "In the Matter of California Associated Products Co., a corporation, doing business as Yankee Doodle Root Beer Bottling Company, Debtor," No. 45137-BH. (Certified Transcript of record, p. 2.)

2. That on said date, to wit, July 29, 1947, an Approval and an Order of Reference was made by the said District Court, and the said matter was referred for all purposes to Referee Hugh L. Dickson. (Certified transcript, p. 13.)

3. That the Plan of Arrangement failed and that on April 20, 1948, the above mentioned debtor was adjudicated a bankrupt by an Order of the Referee filed on April 26, 1948.

4. That on June 21, 1949, Appellant filed with the Clerk of the District Court, and concurrently with the Notice of Appeal, a Bond for Costs on Appeal, in the sum of \$250.00, and executed by Fireman's Fund Insurance Company as surety. (Certified transcript, p. 65.)

5. That Exhibits "1" and "2" may be photostated in lieu of printing the same.

6. That the matters referred to in points 1, 2, 3, and 4 may be used on this appeal in lieu of printing the documents to which they relate.

Dated this 16th day of September, 1949.

CHARLES J. KATZ,

By /s/ SAMUEL W. BLUM,

Attorneys for Appellant.

CRAIG, WELLER &

LAUGHARN,

By /s/ THOMAS S. TOBIN,

Attorneys for E. A. Lynch.

/s/ AARON LEVINSON,

Appearing in Pro Per.

/s/ HUGH W. LUTZ,

Attorney for Victor Kramer.

/s/ JOHN E. WALTERS,

Attorney for Bank of America National Trust and
Savings Association.

/s/ FRANK T. COTTER,

Attorney for F. W. Boltz
Corporation.

/s/ MAURICE M. GOODSTEIN,

Attorney for Leo Brill.

Attorneys for Appellees.

[Endorsed]: Filed Oct. 12, 1949.

[Title of Court of Appeals and Cause.]

APPELLANT'S DESIGNATION OF POR-
TIONS OF RECORD TO BE PRINTED
AND PHOTOSTATED.

To the Clerk of the Above Entitled Court, and to
the Appellees and Petitioners for Review; Bank
of America National Trust and Savings As-
sociation, Leo Brill, F. W. Boltz Corporation,
a California Corporation, Victor Kramer, and
Aaron Levinson, and to Their Respective Coun-
sel of Record, and to E. A. Lynch, Receiver
and Trustee in the Above Entitled Action, and
to His Counsel of Record:

Comes Now The Appellant, Wil-Rud Corporation,
and hereby designates the portions of the record
requested by appellant to be printed and photo-
stated, to wit:

A. Portions of the Record to Be Printed as Re-
quested by Appellant:

1. Stipulation in Lieu of Printing Portions of Record, dated September 16, 1949.

2. Transcript of the evidence of the hearing on October 15, 1947, before Referee Hugh L. Dickson.

3. Petition for Order to Show Cause re Wil-Rud Corporation, filed October 31, 1947.

4. The Order to Show Cause issued on October 31, 1947, by Referee Hugh L. Dickson on the aforementioned petition designated under No. 3 hereof, requiring the Wil-Rud Corporation to appear on November 7, 1947.

5. Transcript of the evidence of the hearing held before Referee Hugh L. Dickson on November 7, 1947.

6. Petition for Leave to Compromise re Wil-Rud Corporation Sale, dated December 26, 1947, and filed on or about January 6, 1948.

7. Notice of Hearing on Petition to Compromise and Sale of Assets Receivable, dated January 14, 1948.

8. Findings of Fact, Conclusions of Law and Order Approving Petition for Leave to Compromise re Wil-Rud Corporation sale, signed by Referee Hugh L. Dickson on February 26, 1948.

9. Transcript of the evidence on the hearing re petition for compromise held on January 29, 1948, before Referee Hugh L. Dickson.

10. Petition for Review of Referee's order dated

February 26, 1948, filed by petitioners, Aaron Levinson, Bank of America National Trust and Savings Association, Leo Brill, F. W. Boltz Corporation, a California corporation, and Victor Kramer.

11. Referee's Certificate on Review, dated March 24, 1948, re the petition of the aforesaid creditors to review order of February 26, 1948.

12. The Memorandum Opinion of Federal District Judge Ben Harrison reversing the order of the Referee on the Petition for Review of Aaron Levinson, Bank of America, Leo Brill, F. W. Boltz Corporation and Victor Kramer.

13. Minute Order of Federal District Judge Ben Harrison, dated on or about December 16, 1948, reversing the order of the Referee on the Petition for Review of Aaron Levinson, Bank of America, Leo Brill, F. W. Boltz, and Victor Kramer.

14. Findings of Fact and Conclusions of Law and Order granting Petition for Review and reversing Order of Referee Approving Compromise, signed by District Judge Ben Harrison and entered on or about May 26, 1949, in Judgment Book 58, page 475.

15. Notice of Appeal filed by Wil-Rud Corporation on or about June 21, 1949.

16. The order of Referee Hugh L. Dickson entered on October 22, 1947, confirming and approving sale to Wil-Rud Corporation, a corporation.

17. Statement of Appellant's Points Intended to Be Relied Upon on Appeal.

B. Portions of the Record to Be Photostated As Requested by Appellant.

1. Petitioners' Exhibit No. 1, being Itemization of Inventory Shortages.

2. Petitioners Exhibit No. 2, being Inventory of Assets.

Dated this 7 day of October, 1949.

Respectfully submitted,

CHARLES KATZ,

By /s/ SAMUEL W. BLUM,

Attorneys for Appellant.

Affidavit of Service by Mail Attached.

[Endorsed]: Filed Oct. 12, 1949.

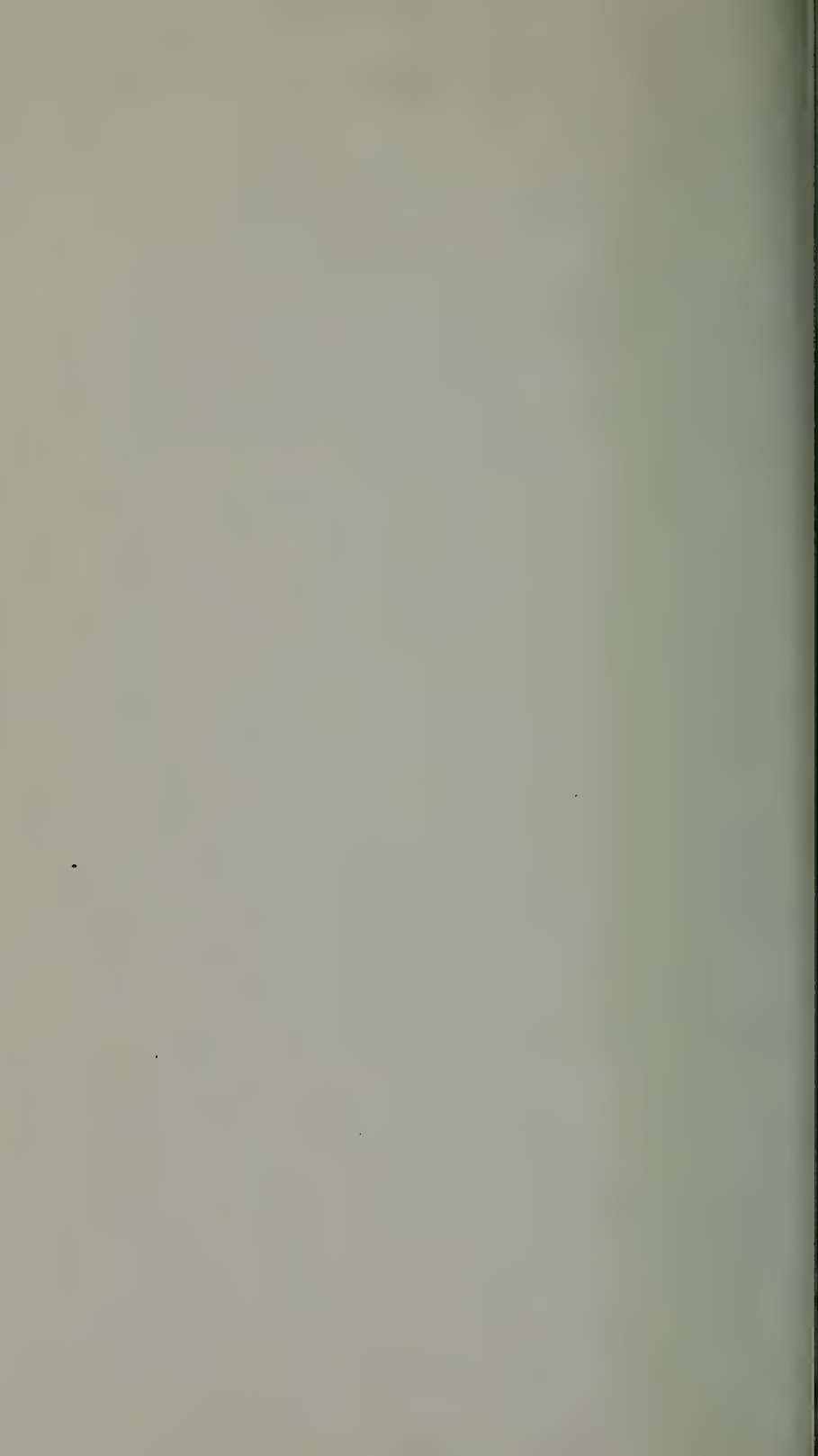
At a Stated Term, to wit: The October Term 1949, of the United States Court of Appeals for the Ninth Circuit, held in the Court Room thereof, in the City and County of San Francisco, in the State of California, on Wednesday the second day of November in the year of our Lord one thousand nine hundred and forty-nine.

Present: Honorable Willian Healy,
Circuit Judge, Presiding,
Honorable Homer T. Bone,
Circuit Judge,
Honorable Walter L. Pope,
Circuit Judge.

[Title of Cause.]

ORDER THAT EXHIBIT 2
NEED NOT BE PRINTED

Good cause therefor appearing, It Is Ordered that Petitioner's Exhibit 2, Inventory of Assets, a ninety-four page itemization, need not be reproduced in the printed transcript of record but will be considered by the court in its original form.



No. 12309.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of

CALIFORNIA ASSOCIATED PRODUCTS Co., a corporation,
doing business as YANKEE DOODLE ROOT BEER BOT-
TLING COMPANY,

Bankrupt.

WIL-RUD CORPORATION,

Appellant,

vs.

E. A. LYNCH, *et al.*,

Appellees.

APPELLANT'S OPENING BRIEF.

CHARLES J. KATZ,
1220 Garfield Building, Los Angeles 14,
Counsel for Appellant.

SAMUEL W. BLUM,
Of Counsel.

FILED

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No. 12309.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of

CALIFORNIA ASSOCIATED PRODUCTS Co., a corporation,
doing business as YANKEE DOODLE ROOT BEER BOT-
TLING COMPANY,

Bankrupt.

WIL-RUD CORPORATION,

Appellant,

vs.

E. A. LYNCH, *et al.*,

Appellees.

APPELLANT'S OPENING BRIEF.

Introductory Statement.

This is an appeal by Wil-Rud Corporation, a party aggrieved, from a certain Order of the United States District Court, Southern District of California, Honorable Ben Harrison, Judge presiding, entered on May 26, 1949, granting the Petition for Review of Aaron Levinson, Bank of America, National Trust and Savings Association, Leo Brill, F. W. Boltz Corporation, and Victor Kramer, and reversing the Order of Referee Approving Compromise, dated February 26, 1948, wherein the Referee had approved a compromise between E. A. Lynch, Receiver, and Wil-Rud Corporation.

Appellant, Wil-Rud Corporation, is the purchaser of certain assets of the bankrupt from the Receiver, free

and clear of all liens, incumbrances, and charges, at a sale held in open Court before the Referee on October 15, 1947. By the terms of the Order of Confirmation of Sale the payment of the purchase price of \$161,000.00 was to be made concurrently with the delivery of the assets by the Receiver to the purchaser, Wil-Rud Corporation. Thereafter, appellant, Wil-Rud Corporation, asserted that all the assets purchased were not delivered to it by the Receiver, and that certain of said assets so purchased were not free and clear of all liens, incumbrances, and charges. This caused a controversy between Wil-Rud and the Receiver, and a hearing was had before the Referee who indicated that he would uphold the claims of Wil-Rud. As a result considerable negotiations were had between Wil-Rud and the Receiver culminating in the filing, by the Receiver, of a Petition for Leave to Compromise Controversy. After due notice, a hearing upon said petition was held before the Referee who made an order approving the compromise, by which, among other things, Wil-Rud was allowed a credit of \$18,500.00 upon the purchase price.

The appellees, Aaron Levinson, Bank of America, National Trust and Savings Association, Leo Brill, F. W. Boltz Corporation, and Victor Kramer, are unsecured creditors of the bankrupt. They filed a Petition for Review of the Referee's order approving the compromise, and on May 26, 1949, an order of the District Court was entered granting the said Petition for Review and reversing the Referee's order approving the compromise.

The District Court not only reversed the Referee's approval of the compromise, *but went much further and attempted to and purportedly did determine on the merits the actual controversy between Wil-Rud and the Re-*

ceiver, which was the subject matter of the disputes between them, thereby depriving Wil-Rud of its day in Court on the merits of said disputes. This the District Court could not do upon the *Petition for Review*. *It could either approve or reject the compromise; it certainly could not determine the merits of the disputes between Wil-Rud and the Receiver upon such petition.*

Appellee, E. A. Lynch, is the Receiver and Trustee of said bankrupt. He has not appealed from the aforesaid Order of the District Court, but has been named as an appellee herein, as his rights and interest in the matter will be materially affected by the determination of this appeal.

Statement of Jurisdiction.

1. The statutory provisions believed to sustain the jurisdiction of the District Court are as follows: U. S. C. A., Title 11, Section 1, subdivision 10, as amended, providing that “. . . courts of bankruptcy shall include the District Courts of the United States . . .” (Bankruptcy Act, Sec. 1, sub. 10);¹ U. S. C. A., Title 11, Section 11, subdivision (a), as amended, providing that “The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits . . . with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this title . . .” (Bankruptcy Act, Sec. 2); U. S. C. A., Title 11, Chapter 11, Sections 701 to 799, as amended, entitled, and providing for “Arrangements,” meaning “. . . any plan of a debtor for the set-

¹All references to the Bankruptcy Act refer to the Chandler Act, as amended.

tlement, satisfaction, or extension of time of payment of his unsecured debts upon any terms; . . .” (Bankruptcy Act, Chap. XI, Secs. 301 to 399); U. S. C. A., Title 11, Section 50, as amended, providing “The receiver or trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interests of the estate.” (Bankruptcy Act, Sec. 27); U. S. C. A., Title 11, Section 67c, as amended, providing that “A person aggrieved by an order of a referee may, . . . file with the referee a petition for review of such order by a judge . . .” (Bankruptcy Act, Sec. 39c.)

2. The existence of jurisdiction of the District Court is shown by the following pleadings:

(a) Petition for Plan of Arrangement under U. S. C. A., Title 11, Chapter 11, as amended (Chap. XI, Bankruptcy Act) filed on July 29, 1947, by California Associated Products Co., a corporation, doing business as Yankee Doodle Root Beer Bottling Company, as the then debtor, in the District Court of the United States, Southern District of California, Central Division, in that certain proceedings entitled, “In the Matter of California Associated Products Co., a corporation, doing business as Yankee Doodle Root Beer Bottling Company, Debtor,” No. 45137-BH. By said petition the aforesaid debtor sought an Arrangement with its creditors under the provisions of Chapter XI of the Bankruptcy Act. [R. 179.]

(b) An Approval and Order of Reference on July 29, 1947, was made by said District Court in the aforesaid matter, and the said matter was referred for all purposes to Referee Hugh L. Dickson. [R. 179, par. 2.]

(c) A Petition for Leave to Compromise was filed January 6, 1948, before the Referee, by Receiver, seeking

to compromise the controversy existing between Receiver and Wil-Rud Corporation. [R. 12-16.]

(d) Notice of Hearing of Petition to Compromise and Sale of Accounts Receivable was given to all of the creditors, setting forth the time and place of the hearing, and the terms of the proposed compromise. [R. 16-19.]

(e) Written Findings of Fact, Conclusions of Law, and Order Approving Petition for Leave to Compromise Wil-Rud Corporation Sale were duly made and filed on February 26, 1948, by the Referee, and by said Order the compromise set forth in the aforesaid petition was approved, and Wil-Rud Corporation was allowed a credit of \$18,500.00 upon the purchase price of assets previously purchased by it from the Receiver. [R. 20-24.]

(f) Petition for Review of Referee's Order dated February 26, 1948, by Judge, was filed with the Referee on March 8, 1948, by appellees, Aaron Levinson, Bank of America, National Trust and Savings Association, Leo Brill, F. W. Boltz corporation, and Victor Kramer, to review the Order of the Referee approving said compromise by the District Judge. [R. 25-28.]

(g) Order of the Referee filed April 26, 1948, adjudicating the debtor a bankrupt after the Plan of Arrangement had failed. [R. 180, par. 3.]

(h) Written Findings of Fact, Conclusions of Law, and Order Granting Petition for Review and Reversing Order of Referee Approving Compromise were filed by the District Judge on May 24, 1949, and said Order was entered and docketed on May 26, 1949. [R. 44-48.]

(i) By Order of the District Judge, permission was granted to the Wil-Rud Corporation to appear and file a brief in connection with the Petition for Review and the hearing thereon. [R. 44.]

3. The statutory provisions believed to sustain the jurisdiction of the United States Court of Appeals for the Ninth Circuit are as follows: U. S. C. A., Title 11, Section 47, subdivision (a), as amended, providing "The Circuit Courts of Appeal of the United States . . . are hereby invested with appellate jurisdiction from the several courts of bankruptcy in their respective jurisdictions in proceedings in bankruptcy, either interlocutory or final, and in controversies arising in proceedings in bankruptcy to review, affirm, revise or reverse, both in matters of law and in matters of fact . . ." (Bankruptcy Act, Sec. 24a); U. S. C. A., Title 11, Section 47, subdivision (b), as amended, providing "Such appellate jurisdiction shall be exercised by appeal and in the form and manner of an appeal." (Bankruptcy Act, Sec. 24b); U. S. C. A., Title 11, Section 48, subdivision (a), as amended, providing "Appeals under this title to the Circuit Court of Appeals of the United States . . . shall be taken within thirty days after written notice to the aggrieved party of the entry of the judgment, order or decree complained of, . . . or if such notice be not served and filed, then within forty days from such entry." (Bankruptcy Act, Sec. 25, sub. a.)

The existence of jurisdiction of the Court of Appeals is shown by the following:

(a) The Order of the District Judge granting the Petition for Review and reversing the Order of Referee Approving Compromise was entered and docketed on May 26, 1949. [R. 48.]

(b) The Notice of Appeal from the aforesaid Order of the District Court was filed by appellant with the Clerk of the District Court on June 21, 1949. [R. 49.]

(c) Concurrently with the filing of the Notice of Appeal, to-wit, on June 21, 1949, appellant filed with the Clerk of the District Court a Bond for Costs on Appeal as required by law. [R. 180, sub. 14.]

Statement of the Case.

A. The Pleadings and the Issues.

1. THE ORDER CONFIRMING AND APPROVING SALE.

On October 22, 1947, the Referee signed and filed an Order confirming and approving the sale of certain assets by the Receiver to Wil-Rud Corporation. Said Order was made a part of the Referee's Certificate on Review. [R. 35]. Since the controversy involved stems from said sale, the pertinent portions of said Order become important. The following are the material terms thereof:

"Now, Therefore, the undersigned Referee does hereby approve and confirm the sale by E. A. Lynch, as Receiver in the within estate, of certain personal property, hereinafter described, to Wil-Rud Corporation, a corporation, for a cash consideration to be paid to said E. A. Lynch, as Receiver, in the sum of \$161,000.00, *delivery of the assets to be made upon the signing of the within order, and payment therefor to be made concurrently with delivery to the buyer.*"²

"1. The Receiver, by this order, is deemed to have sold, and does sell to the buyer, all machinery, fixtures, equipment, *all inventory*,³ all lessee's improvements, all furnishings, all supplies, and all finished and unfinished products of every class and character and description whatsoever located at 3631 Union Pacific Avenue, Los Angeles, California, *together with all the other physical assets of the debtor corporation, wheresoever situated*,⁴ and together with all of the physical assets of every class and character of the Yankee Doodle Root Beer Company, a corpo-

ration, as of December 15, 1947, at 5:00 o'clock P. M.; *all of said items are sold free and clear of any liens, charges, and encumbrances,*⁵ save and except a balance owing on a sales contract to the Los Angeles Water Softener Company in the sum of \$1,-699.17, which balance the purchaser assumes and agrees to pay." [R. 3-4.]

The Order further provided for the transfer by Receiver to buyer of all right, title and interest of the estate in and to a certain lease, together with any arrangement or understanding which certain officers of the debtor may have had with the owner for any extension thereof, or for any new lease; said Order also transferred to buyer all issued and outstanding shares of capital stock of Yankee Doodle Root Beer Company, and all ownership, right, title and interest of the estate in and to patents, processes, formulae, good will, copyright, trade names, trade marks, royalties, licensing agreements. The last provision excluded certain assets from the sale, none of which are involved herein. [R. 4-7.]

- It is apparent that the terms of the aforesaid Order made payment of the purchase price by buyer *concurrent* with the delivery to it of the assets, and included, among the assets sold, "*all inventory,*" and "*all the other physical assets of the debtor corporation, wheresoever situated.*"

2. PETITION FOR ORDER TO SHOW CAUSE RE WIL-RUD CORPORATION SALE.

Upon the signing of the Order of Confirmation, Wil-Rud paid the Receiver \$100,000.00, and certain assets were delivered to it. Wil-Rud, however, claimed that all assets purchased were not delivered to it, and that its obligation

², ³, ⁴ and ⁵Italics ours.

to pay the purchase price, by the terms of said Order, was conditioned upon receipt of the assets purchased.

On October 31, 1947, the Receiver filed the aforementioned petition to recover the balance of the purchase price. This petition also was attached to the Referee's Certificate on Review. [R. 35.]

The Receiver alleged the sale on October 15, 1947, and the confirmation thereof by written Order on October 22, 1947. That \$100,000.00 of the purchase price was paid, and that \$61,000.00 remained unpaid; that Wil-Rud desired an adjustment thereof in that, based upon an inventory prepared by Receiver, certain items of personal property were missing, valued at \$15,488.99, and that errors existed in the inventory in the sum of \$3,463.17, making a total difference claimed of \$18,952.16. The Receiver then alleged that all assets sold were tendered to purchaser; that the \$61,000.00 was due without any allowance of offsets, in that the sale was not predicated upon the inventory, but was made solely in accordance with the Order confirming the sale. [R. 8-9.]

3. PETITION FOR LEAVE TO COMPROMISE RE WIL-RUD CORPORATION SALE.

The proceedings directly involved in this appeal begin with the aforementioned Petition for Leave to Compromise filed by the Receiver on January 6, 1948, with the Referee. Receiver therein alleged that on October 15, 1947, Wil-Rud Corporation purchased certain assets for \$161,000.00; that certain differences arose between purchaser and Receiver; that the purchaser contended that it bought all those physical assets reflected by a certain inventory filed in the Debtor Proceedings, being Respondent's Exhibit No. 2, introduced by Receiver at the hearing

before the Referee on November 7, 1947. That at this hearing, Wil-Rud Corporation contended that it was entitled to an adjustment on inventory shortages in the sum of \$19,336.86. That subsequent thereto, Wil-Rud Corporation presented additional claims, based upon page 88-a of said inventory, itemizing a total of \$47,976.29 worth of root beer bottles and cases alleged to be in the vicinity or territory of Los Angeles, California; that the debtor had taken deposits of 60 cents per case from its customers, who by virtue of possession of the cases and bottles had a lien thereon until the 60 cents was repaid; that purchaser had other claims, contending that it paid warehouse and other charges on items purchased free and clear.

The petition stated Receiver contended that the assets were sold "where is, as is" as of October 15, 1947, but that there was merit to the Wil-Rud's claims, since the issues as to the inventory shortages had been submitted, to the Referee on November 7, 1947, and that at said hearing the Referee had indicated that he would determine that matter in favor of purchaser.

The petition then alleged that after a full and complete inter-change of facts, numerous conferences and negotiations, a compromise and settlement was offered by Wil-Rud, which was recommended by the Receiver as being for the best interests of the said estate, as follows:

(a) That a credit of \$18,500.00 would be allowed upon the purchase price, making the same \$142,500.00, and leaving a balance of \$17,500.00 thereon, which purchaser would pay upon approval of the compromise.

(b) That purchaser offered to buy certain outstanding accounts receivable, and agreed to hold Receiver free and harmless of refunds up to 60 cents per case, containing twenty-four bottles, surrendered to the purchaser.

(c) That all claims of every kind, nature and character which either Receiver or Wil-Rud had against the other, would be settled.

The prayer requested that due notice to creditors be given; that a hearing be had, and that the said compromise be approved. [R. 12-16.]

4. NOTICE OF HEARING ON PETITION TO COMPROMISE.

This notice stated that a meeting of the creditors would be held on January 29, 1948, at the Referee's Court Room to hear the petition of the Receiver to compromise, and set forth therein the dispute, the various contentions in respect thereto, and the terms of the proposed compromise. [R. 16-19.]

5. FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER APPROVING PETITION TO COMPROMISE.

After a hearing, the Referee approved the compromise, excluding therefrom the accounts receivable, and on February 26, 1948, made and filed his Findings of Fact, Conclusions of Law, and Order. The Referee found as true the appointment and qualification of the Receiver; that a controversy existed between Receiver and Wil-Rud and that their contentions were as set forth in the petition; that Wil-Rud Corporation could reasonably contend that it was entitled to an adjustment of \$28,000.00; that it was for the best interests of the estate to permit the compromise of the pending matters, and other claims by allowing a reduction of \$18,500.00 on the purchase price, thereby reducing the same to \$142,500.00, and leaving a balance of \$17,500.00 due and payable. That certain of the objecting creditors (constituting some of appellees herein) had approved a bid of \$135,000.00 and had submitted it to the Court on October 15, 1947, and requested

the Court not to accept any higher bids. That on November 7, 1947, the Court had considered the claims of Wil-Rud Corporation concerning shortages, and had indicated from the bench that it appeared from the evidence that the purchaser had relied upon the inventory prepared in said estate and therefore was entitled to pro rata credits for the shortages in the inventory. That as a part of said compromise, purchaser, Wil-Rud Corporation, was to hold the Receiver harmless for any refunds on cases up to 60 cents per wooden case containing twenty-four bottles. That upon payment of the \$17,500.00, all claims of Wil-Rud Corporation and Receiver as against the other arising from said sale would be compromised and settled in full. That it would be an unwise expense to direct the Receiver to quiet the title of the many hundred retailers with whom the Debtor had dealt, to enable Receiver to surrender the wooden cases and bottles to Wil-Rud Corporation, free and clear of any claims; that it would be cheaper for the Receiver to complete the proposed compromise than attempt to deliver approximately 25,000 cases free and clear of all claims, pursuant to the representations contained on page 88-a of the inventory described in Paragraph II of the Petition for Leave to Compromise. Referee found that it was not for the best interests of the estate to approve the proposed sale of the accounts receivable and therefore did not include the same as a part of the approved compromise and settlement.

The Referee then made the following Conclusions of Law: That it would be for the best interests of the estate to approve the compromise and settlement submitted in the petition, excepting therefrom the sale of the accounts receivable, and that the objections to the proposed compromise and settlement were not well taken.

Based upon the foregoing, the Referee made the following Order: That the petition of E. A. Lynch, as Receiver, to compromise and settle the claims involved in the sale to the Wil-Rud Corporation be, and the same was approved. That Wil-Rud Corporation was ordered to pay the Receiver the balance of \$17,500.00 upon the purchase price, and Wil-Rud was ordered to hold the Receiver, and the said estate, harmless from any claims for refunds on cases up to 60 cents per wooden case. [R. 20-24.]

6. PETITION FOR REVIEW OF REFEREE'S ORDER.

Thereafter, and on March 8, 1948, Aaron Levinson, Bank of America, National Trust and Savings Association, Leo Brill, F. W. Boltz Corporation, a California corporation, and Victor Kramer filed with said Referee the aforesaid Petition for Review, alleging therein that each of the petitioners was a creditor of the said debtor, having aggregate claims in excess of \$200,000.00. That the Receiver filed a Petition for Leave to Compromise the asserted claim by Wil-Rud and prayed that the same be approved and that they had appeared at the hearing of said petition. That on February 26, 1948, an Order was made by the Referee granting the petition, setting forth the substance of said Order. The petition then alleged that the said Order was erroneous as follows:

(a) That neither the Receiver nor Referee gave the creditors any information in the notice to them as to the nature of the claims, the amount of the claims, or the shortages claimed by the Wil-Rud Corporation.

(b) That nowhere in the proceedings, or in the notice to creditors, did it appear what the shortages were or on what Wil-Rud Corporation based its contentions that it was entitled to an adjustment on inventory shortages in the sum of \$19,336.88.

(c) That the claims of Wil-Rud Corporation based on inventory shortages was without merit, since the Order confirming the sale transferred to Wil-Rud Corporation all right, title and interest of the estate, of all machinery, etc., located at 3631 Union Pacific Avenue, Los Angeles, California, together with other physical assets of the Debtor corporation "wherever situate . . . as of October 15, 1947, at 5:00 o'clock p. m."

(d) That the claim of Wil-Rud that Debtor's customers who had deposited 60 cents with Debtor had a lien on each wooden case was without merit.

(e) That the claimed lien was conjectural.

(f) That the record did not show how the Receiver arrived at the amount of \$18,500.00 allowed the purchaser.

(g) That there was no substantial evidence introduced upon which the merits or demerits of the Petition for Leave to Compromise could be determined.

(h) That the merits of the claims of Wil-Rud Corporation first should have been determined before approval of the compromise.

(i) That no substantial evidence was offered to show that the proposed compromise was for the best interest of the creditors. [R. 25-28.]

7. REFEREE'S CERTIFICATE ON REVIEW.

The Referee prepared and presented to the District Judge his Certificate on Review, stating in substance that E. A. Lynch was the duly appointed, qualified and acting Receiver in the within Chapter XI reorganization proceedings, and pursuant to Order of Appointment he took possession and continued operation of the business previously conducted by Debtor, consisting primarily of bottling of root beer and the sale of the root beer extracts. That

the major portion of the physical assets involved were located at the main bottling plant, 3631 Union Pacific Avenue, Los Angeles, California, and that in the administration of the estate, it became advisable for the Receiver to attempt to sell the assets of said estate. That after due notice to creditors, hearings were held before the Court on September 15, October 7, and October 15, 1947. That on October 15, 1947, Aaron Levinson, on behalf of C. Ray Miller, read to the Court an offer of \$135,000.00 for the assets of the Debtor corporation, and had requested the Court to accept that offer, and not to permit competitive bidding for the assets. That said attorney purported to submit the offer and the request that it be approved, on behalf of the members of the Committee of Creditors, which included Aaron Levinson, Bank of America, National Trust and Savings Association, and F. W. Boltz Corporation, three of the creditors petitioning for review. Referee then stated that he opened the matter for competitive bidding and that Wil-Rud Corporation made the highest and best bid, offering \$161,000.00 cash for the assets. That on October 22, 1947, said Referee signed an Order confirming the sale, and possession of said assets was given to Wil-Rud. That thereafter a dispute developed between the Receiver and purchaser, and pursuant to a verified petition, an Order to Show Cause was issued directing the purchaser to appear before the Referee on November 7, 1947, to show cause why the balance of the purchase price should not be paid. At said time the Wil-Rud Corporation had paid \$100,000.00 toward the purchase price; that the Committee of Creditors had been informed of the Order to Show Cause, and some of them were present at the hearing. That from the evidence presented it appeared to the Referee that Wil-Rud Corporation had submitted its bid in reliance upon the inventory

admittedly shown by Receiver's representative to Samuel C. Rudolph, purchaser's representative. That at the hearing on November 7, 1947, Exhibit 1 was introduced, reflecting the claimed inventory shortages totalling a gross amount of \$18,952.16. That Exhibit 2 introduced at said hearing was the inventory which was relied upon by the purchaser in making its bid. That at this hearing the Referee had indicated that he would rule that the purchase was made pursuant to the inventory, and that a pro rata allowance would be made to the bidder. That on November 7, 1947, there also was brought to the Court's attention that the purchaser was contending for an adjustment involving wooden cases and bottles used by the Debtor in the sale and delivery of its root beer products. That thereafter a petition was filed by Receiver to compromise the claims of Wil-Rud Corporation centering upon two problems: First, the inventory shortages covered in the hearing held on November 7, 1947; and second, a contention by the purchaser that the items contained on page 88-a of the inventory could not be delivered free and clear to the purchaser in that retail distributors had possession of the wooden cases and bottles involved and had paid 60 cents per case as a deposit thereon, and therefore had a lien for the amount of 60 cents per case predicated on their possession of the cases. That the gross amount in value of the cases and bottles involved was \$47,976.29, and if this figure were recognized, then 40 per cent thereof would be the pro-rated deduction allowable to the purchaser. On the other hand, 25,807 wooden cases were involved, and if the estate were required to pay 60 cents per case to clear any claim of lien against the cases, the total involved would be \$15,484.20. That after due written notice to creditors and interested parties, a hearing was had upon the petition of the Receiver to

compromise, including the aforesaid claims of Wil-Rud Corporation, and all other claims which Wil-Rud might have on the basis that an \$18,500.00 reduction would be allowed on the total purchase price, making the net amount payable to the estate \$142,500.00, and after allowing all payments previously made, the balance remaining would then be \$17,500.00, and in addition thereto Wil-Rud Corporation agreed to hold the Receiver harmless of any claims or refunds arising from any attempts to return the cases by the distributors. That the hearing on said petition was had on January 29, 1948. That included at said hearing was a petition to sell outstanding accounts receivable, but after a consideration of the facts involved, the Referee denied the petition to sell and directed the Receiver to make his own collections. That on January 29, 1948, the Referee took the testimony of certain witnesses, to-wit, Ralph J. Yates, the accountant employed by Receiver and the testimony of Wolf Wilder and Samuel C. Rudolph, as agents of the purchaser, Wil-Rud Corporation. That after considering the facts, the arguments of counsel, and the objections of various creditors, the Referee determined that it would be for the best interests of the estate to approve the petition to compromise. The Referee further stated that he was convinced that the purchaser had relied upon the written inventory handed to its agents in preparation for bidding upon the assets. That the Referee further was convinced that the physical assets were sold free and clear to the purchaser, and that there was a strong possibility that the Receiver could not deliver clear title to the wooden cases and bottles involved without compensating the distributors to the extent of 60 cents per wooden case, since the distributors had possession of the cases and appeared to have a claim of lien thereon until the 60 cents deposit was returned, and that in addi-

tion thereto there was involved the practical problem of quieting title to thousands of wooden cases located in the hands of thousands of vendees. That under all circumstances, considering the legal and equitable problems involved, and the possibility of adverse rulings against the Receiver in the event of contested litigation and the expense of such litigation, the Referee ordered the proposed compromise with the Wil-Rud Corporation approved, and made Findings of Fact, Conclusions of Law and an Order thereon dated February 26, 1948. The Referee also stated that no order was sought, or obtained by the petitioners for review authorizing the filing of said petition, although they were not parties to the petition to compromise the differences between the Receiver and the Wil-Rud Corporation. The Referee recited that he had proceeded in pursuance to Section 27 of the Bankruptcy Act, U. S. C. A., Title 11, Chapter 4, Section 50, governing compromises. The Referee attached to the certificate the following documents: The Reporter's Transcript of Proceeding held on October 15, 1947; the Order Confirming Sale, dated October 22, 1947; Petition of Receiver for an Order to Show Cause directed against Wil-Rud; Order to Show Cause against Wil-Rud Corporation, issued October 31, 1947; Reporter's Transcript of the hearing held on November 7, 1947; Petitioner's Exhibit No. 1, containing itemization of inventory shortages; Petitioner's Exhibit No. 2, being the written inventory of the assets; Petition of Receiver, dated January 6, 1948, for Leave to Compromise; Notice of Hearing on Petition for Leave to Compromise, dated January 14, 1948; Reporter's Transcript of hearing held on January 19, 1948; Findings of Facts and Conclusions of Law and Order, approving Petition for Leave to Compromise; Petition dated March 4, 1948, for Review of the Referee's Order. [R. 29-36.]

8. FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER GRANTING PETITION FOR REVIEW AND REVERSING ORDER OF REFEREE.

On December 16, 1948, the District Judge filed a Memorandum Opinion granting the Petition for Review and Reversing the Referee's Order. [R. 37-43.] On May 24, 1949, he made and filed written Findings of Fact, Conclusions of Law, and the Order Granting the Petition for Review and Reversing the Order of Referee Approving Compromise. This Order was duly docketed and entered on May 26, 1949. The District Judge found the following: That E. A. Lynch was the duly qualified and acting Receiver and had conducted the going business of the bankrupt from his appointment on July 29, 1947, to October 15, 1947. That on October 15, 1947, he brought on for sale in open Court before the Referee certain assets of the Debtor, at which time there was competitive bidding. That a bid of \$160,000.00 was offered and thereupon a bid of \$161,000.00 was made on the same terms by the Wil-Rud Corporation for "all of the outstanding shares of Yankee Doodle Root Beer Company and for the physical assets of California Associated Products." That said bid and offer was accepted by the Court and Receiver, and the sale was confirmed by Order of Referee, and that Wil-Rud Corporation paid \$125,000.00 on the purchase price of \$161,000.00; that the business and assets had been in the possession of the Receiver for a period of time and the Receiver had been carrying on the business of the bankrupt corporation. That his inventory of assets made at the inception of the proceedings was not corrected or adjusted from day to day, and did not purport to be other than an inventory of July 28, 1947, which fact was made known to all bidders. That the assets were offered "as is" without warranty as

to quality or quantity and without reference to inventory. That immediately after the confirmation of the sale, the assets sold were delivered to Wil-Rud Corporation. That the Referee's Order approving and confirming the sale was approved in writing by Wil-Rud Corporation and signed by the Referee on October 22, 1947. That thereafter a controversy arose between the purchaser and Receiver, as set forth in Paragraph II, subdivisions (a) and (b), of the Receiver's Petition for Leave to Compromise, and thereafter the Receiver petitioned for authority to compromise the controversy. That ten days' notice was given to all creditors and upon the hearing the petitioners on review objected to the compromise, and that the record failed to disclose any creditors in favor of the compromise. That the sale was not one based upon the assets as reflected by the Receiver's inventory, nor was the bid of Wil-Rud so made, and that Wil-Rud was not warranted in relying, and that it did not rely upon the inventory in making its bid. That it was not for the best interests of the creditors that the proposed compromise be ordered. That no review was taken at any time by Wil-Rud from the Order of confirmation of sale, and that the same became final and that Wil-Rud took no steps to set aside said sale or return the property delivered to it by Receiver.

That the District Judge then made the following *Conclusions of Law*: That the Order of October 22, 1947, confirming the sale to Wil-Rud for \$161,000.00 was final; that no review was taken therefrom. That the said proceedings for compromise could not be maintained as a collateral attack upon the said Referee's Order confirming sale. That the equities were not with the purchaser in that there was a \$160,000.00 bid which was rejected because Wil-Rud increased the bid by \$1,000.00, and that the said bid of \$160,000.00 was for the assets as then

existing and not with the qualifications or restrictions insisted upon by Wil-Rud. That the creditors of the bankrupt would suffer a \$18,500.00 loss if the Order of compromise were approved. That Wil-Rud did not disaffirm the sale but took possession of the assets and could not by a compromise attack the sale, and that Wil-Rud was bound by the rule of *caviat emptor*. That there was no evidence that anybody ever claimed a lien against the property purchased by Wil-Rud, other than the conditional sales contract specifically mentioned.

Based upon the foregoing, the District Judge made an order reversing the Referee's Order, dated February 26, 1948, approving the Receiver's compromise, and denied the petition to compromise. [R. 48.]

B. Statement of Facts.

On July 27, 1947, California Associated Products Co., a corporation, doing business as Yankee Doodle Root Beer Bottling Company, filed a Petition for Plan of Arrangement under Chapter XI of the Bankruptcy Act in the Court below in that certain proceeding entitled, "In the Matter of California Associated Products Co., a corporation, doing business as Yankee Doodle Root Beer Company, Debtor," No. 45137-BH, seeking thereby an arrangement with its creditors. Thereupon an approval and Order of reference was made by the Court and the matter was referred for all purposes to Referee Hugh L. Dickson. [R. 179.] Also, on July 27, 1947, E. A. Lynch was appointed Receiver, and after qualifying, took possession of Debtor's property, and continued the operation of the Debtor's business [R. 29; 45], consisting primarily of bottling of root beer and the sale of root beer extracts. Most of the physical assets involved were

located at the main bottling plant at 3631 Union Pacific Avenue, Los Angeles, California. [R. 29.] Thereafter Debtor failed to submit a satisfactory plan of arrangement [R. 1] and it became advisable for the Receiver to sell the assets of the estate. After due notice to creditors, hearings were held before the Referee on September 25, October 7 and October 15, 1947. [R. 29.] On October 15, 1947, various creditors, including certain of appellees, attended, and Aaron Levinson read to the Court a written offer of \$135,000.00 made by one C. Ray Miller "for all of the outstanding shares of Yankee Doodle Root Beer Company" and "for the physical assets of California Associated Products" and for all trade names, trade marks, all formulas, and registered trade names and lessee's interest in the lease, excluding from said assets merchandise held by the Bank of America as security, cash on hand, accounts and notes receivable and deposits. The insurance was to be taken over on a pro rata basis, and title to the property was to be delivered free and clear, except as to the water softener. [R. 51-53.] Mr. Levinson advised the Referee that it was the unanimous opinion of the creditors representing over \$200,000.00 in amount of claims (constituting the so-called "Committee of Creditors") that the said offer should be accepted, and that the Receiver should be directed to sell to said bidder without further competitive bidding. [R. 29-30; 53-54.] This the Referee refused to do. The matter was opened for competitive bidding [R. 30; 55], and the assets were sold to Wil-Rud Corporation for \$161,000.00 [R. 68; 30] free and clear of all liens, charges, and incumbrances, excepting the said water softener.

On October 22, 1947, the Referee signed and filed his Order, which, among other things, approved and confirmed the sale of certain personal property to Wil-Rud Corpo-

ration for \$161,000.00 cash, and further provided that "delivery of the assets to be made upon signing of the within order, and payment therefor to be made concurrently with delivery to the buyer." Said Order also stated that the Receiver "does sell to the buyer all machinery, fixtures, equipment, *all inventory*, all lessee's improvements, all furnishings, all supplies, and all finished and unfinished products of every class and character and description whatsoever . . . , together with all the other physical assets of the Debtor corporation, *wheresoever situated*, and together with all of the physical assets of every class and character of the Yankee Doodle Root Beer Company, a corporation . . . ; all of said items are *sold free and clear* of any liens, charges and incumbrances" It thus became the obligation of the Receiver under said Order to deliver to Wil-Rud Corporation *all inventory*, together with all of the other physical assets of the Debtor corporation, *wheresoever situated*, and that *concurrently, and only concurrently with said delivery*, the Receiver was entitled to be paid the sum of \$161,000.00. Wil-Rud's obligation to pay, by the terms of said Order, was conditioned upon delivery to it of the described assets.

Such delivery was not made. After a checking of the delivered items by both Receiver and Wil-Rud, it was discovered that certain items set forth in the Receiver's inventory were not delivered to, or received by Wil-Rud, who thereby asserted that it was entitled to a credit upon the purchase price for the missing items. [R. 84-87.] On the other hand the Receiver demanded the balance of the purchase price, and on October 31, 1947, filed a Petition for an Order to Show Cause, to obtain the balance of the purchase price. [R. 8-9.] An Order to Show Cause was issued thereon and Wil-Rud Corporation was

ordered to appear before the Referee on November 7, 1947, to show cause why it should not pay the sum of \$61,000.00, being the unpaid balance of the purchase price. [R. 10-11; 30.] The "Committee of Creditors" were informed of the Order to Show Cause, and several of them, including some of the appellees, appeared at, and participated in the hearing. At this hearing Ralph J. Yates, Receiver's representative, testified as follows:

"Q. Before Mr. Rudolph purchased or made any bid in this case, do you know whether the inventory of July 28, 1947 was handed to him? A. Yes, it was.

Q. You handed it to Mr. Rudolph? A. I did.

Q. Do you remember the date that you handed it to Mr. Rudolph? A. About ten days before the first bidding. . . ." [R. 86-87.]

"Q. Have you handed this inventory to any of the other bidders? A. I had.

Q. And the instrument which I show you is a copy of the inventory which you handed to Mr. Rudolph some time before he started making the bids, is that right? A. It is the same one I handed to him.

Mr. Katz: I would like to have this marked as an exhibit, the inventory.⁶

The Referee: All right." [R. 87.]

On cross-examination Mr. Yates stated:

"A. I told Mr. Rudolph that we had not taken a physical inventory, that Mr. Lynch had been operating the business and the Debtor had been operating the business since July 28, *and naturally there*

⁶This is Petitioner's Exhibit 2, and by Order of this Court need not be reproduced in the printed transcript of record but will be considered by the Court in its original form. [R. 185.]

would be adjustments on the merchandise that had been used in connection with the operation of the business. I don't recall at this time any specific items that I mentioned." [R. 89.] (Italics ours.)

Mr. Yates further testified that shortly after the sale, he met with Mr. Rudolph to arrange for a check of the merchandise by representatives of both Receiver and purchaser, and that thereafter he checked the findings of both representatives. A physical count of the goods turned over to Wil-Rud was made against the original inventory, and a list of shortages was made by both the representatives. [R. 85-89.] Such shortages were specified in a document entitled, "Inventory Shortages at California Associated Products, Inc.," being Petitioner's Exhibit 1. [R. 81-83.] In this respect Mr. Yates testified:

"Q. This column that you prepared entitled 'Shortages,' that is actually a difference in the items that were reflected on the inventory and the items that were offered or delivered to the Wil-Rud Corporation, is that it? A. That is correct. It ties in with the physical check of the representative of the Receiver and the representative of the purchaser.

Q. Added to those items are some additional mistakes that somebody made who prepared the original copy of July 28, is that correct? A. That is correct." [R. 89.]

This document showed the actual differences in the items reflected in the original inventory which was shown to Mr. Rudolph before the sale and the items which actually were delivered to Wil-Rud [R. 89], and disclosed that the actual shortages of merchandise amounted to \$15,-488.99, and, by reason of errors in addition, there were additional shortages amounting to \$3,466.17, making a grand total of \$18,952.16 in shortages.

Mr. Rudolph testified as follows:

“Q. Mr. Rudolph, you are connected with the Wil-Rud Corporation, the purchaser in this proceeding? A. I am.

Q. About ten days before you made any bid in this proceeding did you go down to the place of business of the California Associated Products Company? A. I did.

Q. At that time were you handed an inventory by the representative of the Receiver? A. That is right.

Q. Were you able simply by going through the plant, for instance, to determine whether the quantity of concentrates on hand in the premises was actually the same amount which was shown on your inventory? A. There was no way to tell at all. They handed me the inventory and told me that was there and the only thing that was sold out of the inventory was some Monterey grape juice, or something, to a party by the name of Briggs. That was the only thing that they told me was sold.

Q. In your claim for shortages, did you make any claim for any item like that Briggs Monterey situation? A. No, sir, I did not.

Q. All you were told was sold was this one item? A. That is correct, sir.

Q. By simply looking at the plant were you able to determine whether there were eight thousand gallons of grape concentrate as distinguished from five thousand gallons? A. I think Mr. Yates did mention that there was 8000 because when I checked this inventory he told me, ‘Sam, I think one mistake is on that eight thousand that was supposed to be there when we took this stock over.’ We took for granted an inventory taken by the Receiver or Trustee is always correct and we have bought goods for the last

twenty-five or thirty years and we don't do a lot of checking when we go in and look at an inventory because we know when they check an inventory it is correct. They do make allowances when they are short or over. The reason we didn't pay the balance of the \$161,000, we wanted to check and see if they were going to make good. We checked it once and they were dissatisfied and we had another man go over and make the second check.

Q. Who checked the second time? A. It was checked by the Receiver's man twice. They thought there was something wrong and they rechecked it again. Not only that, but they pointed out it was short and they would make it good.

Q. Who said that? A. Mr. Yates." [R. 98-100.]

It was stipulated that the shortages were as stated upon Petitioner's Exhibit 1. [R. 80, 110.] After argument by counsel, the Referee stated:

"The Referee: I am very much inclined to agree with you. I think a man ought to get what he buys, should get what he bids for. If he doesn't get it, he should not pay for it. You may prepare an order, Mr. Katz, to that effect." [R. 112.]

The problem of the wooden cases was then brought to the Referee's attention and the following proceedings were had:

"Mr. Katz: There remains the problem, Mr. Gendel, which you and I should work out on the assets being turned over to us. I am talking about the bottles we never received. Do you want to discuss that?

Mr. Gendel: I think it should be discussed because we are apparently going to have some litigation on the matter.

Mr. Katz: I think we can reach a stipulation on the facts without taking the Court's time and then submit the question to the Court. Would you like to do that? I think Mr. Lynch and Mr. Rudolph can reach an agreement on what the facts are.

Mr. Gendel: I don't even know what the problem is. If we can stipulate to save the Court time and properly present the facts, we will be glad to do it.

The Referee: Yes, let's do that.

Mr. Katz: I will prepare an order on this phase of it. On the other phase, let's put it over, say, about a week and see if we can get together.

Mr. Gendel: I don't know what it is about. There is nothing on the calendar.

Mr. Katz: Your order simply is to compel us to pay.

Mr. Gendel: That is right.

Mr. Katz: You say you have tendered the assets to us. Well, we want to pay you, but the order says we are to get the assets wheresoever situated.

Mr. Gendel: That is as of October 15.

Mr. Katz: Now, what happened was this. The Debtor had delivered various cases containing bottles, empty bottles or filled bottles of root beer. The customers and the storekeepers who had those cases had paid the Debtor, I think, sixty cents a case. We are entitled to those cases and we would like to get those cases from the customers.

Mr. Gendel: Are they shown as shortages on Exhibit 1?

Mr. Katz: They aren't short. They are in the possession of third parties.

The Referee: You gentlemen get together on a stipulation of facts, if you can.

Mr. Katz: All right. Otherwise, we will bring on a separate proceeding." [R. 112-113.]

The parties thereafter commenced negotiations to adjust the various differences, and finally a proposed compromise was reached. On January 6, 1948, a verified Petition for Leave to Compromise *re* Wil-Rud Sale was filed by Receiver, setting forth the various disputes, and the nature of the proposed compromise [R. 12-16], the substance of which has previously been stated. Due notice to creditors was given [R. 16], and a hearing before the Referee was had upon said petition. The situation, and the various problems with which the Receiver was confronted concerning the question of inventory shortages, was presented, and the fact that the Referee had indicated at the previous hearing that he would decide those issues in favor of Wil-Rud. The question of the wooden cases and bottles in the hands of customers of the Debtor was also presented. The Referee was told that the parties had arrived at a compromise, which, among other things, allowed Wil-Rud a credit of \$18,500.00 on the purchase price. Evidence was then offered by the Receiver upon the petition. Mr. Yates, the Receiver's representative, testified that he had made an investigation of the books and records of the bankrupt, and that generally he had assisted the creditors, the Receiver, and the Court. He further testified as follows:

"Q. With reference to the wooden cases and the twenty-four bottles in each of the wooden cases, what did you find when you investigated the books and records? A. May I refer to the inventory, please? This inventory was taken as of July 28. On page 88-A there appears an item representing 25,807 wooden cases and bottles. In addition to that, there were 74,640 root beer bottles, 634,708 root beer bottles. This item was set forth as alleged to be in the vicinity or territory of Los Angeles, California.

That item was estimated by the deposits that were totaled from the cards that they had out there representing cases outstanding in the territory on which there was a deposit of sixty cents a case.

Apparently no issue is being made of the 74,000 and the 634,000 root beer bottles. Mr. Katz overlooked that, apparently. But on the 26,000 wood shells and bottles, there is a liability of sixty cents on those which would run over \$16,000. On the basis of forty cents on the shortage there would be an adjustment of \$18,000 coming to Mr. Katz; and on the 20,000 shortage that has been ruled on before there would be another \$8000, or \$28,500. I understand he is willing to compromise for \$18,500 and we are making \$10,000 on that matter . . .” [R. 124-125.]

“Q. (By Mr. Gendel): My question was directed for the moment as to how you ascertained to your own satisfaction that sixty cents per shell, as you described it, for over 25,000 shells had actually been paid over to the California Associated Products Company prior to the commencement of the debtor proceedings by the various people who had possession of the cases or shells . . .” [R. 125.] . . .

“The Witness: Here is how I ascertained it. Mr. Brill, the agent and representative of the Creditors Committee, went through the list with the inventory men, and with Mr. Tanner, and tied in with the deposit control that Mr. Tanner had, and in conjunction with these cards that they had in the offices, and on that basis they estimated the outstanding cases and shells.

Q. (By Mr. Gendel): Did you yourself see these cards? A. Yes, I saw the cards.

Q. Were there any notations on the cards reflecting the receipt of sixty cents per shell? A. Yes.

Q. Where are those cards now? A. They are in the office.

Q. Was there any separate books other than regular books of entry of the corporation which indicated the receipt of the moneys? A. Not identifying these particular customers that they had a general control which as it set forth here alleged and estimated and would be very difficult for any one to reconcile.

Q. By checking the regular books and records you could not tell where the money came from or that it was to be applied on these so-called deposits, is that right? A. No . . .” [R. 126.] . . .

“Q. Is there anything in the inventory which reflects that these shells are subject to sixty cents per case? A. No, there isn’t.

Q. You have examined the whole inventory, have you? A. That is correct.

Q. That obligation is not set forth there at all, is it? A. That is correct.” [R. 127.]

On cross-examination by appellees, Mr. Yates stated he did not personally know the exact number of cases in the hands of distributors but that the figures given had been obtained from the records, and that in arriving at the number of cases in the hands of distributors, he took only 50 per cent of the number shown on the records. [R. 128; 141, 142.] He stated that no distributors had contacted him personally for the return of the 60 cents, but that when cases had been returned, the distributors had been credited with 60 cents per case [R. 129]; that customers had put up the deposit when the cases were delivered and had paid the 60 cents to the bankrupt’s drivers. [R. 133.] He stated that he was familiar with the practice, regarding the deposits on cases, used by Debtor,

which practice the Receiver followed; that when cases of root beer were delivered to the customer, 80 cents would be charged for the product and a 60 cent deposit charged for the cases; that a credit of 60 cents per case would be given on returned cases and that the difference between the total charges and the credits on returns would be paid in cash to the driver. [R. 142.] Whenever the customer returned a case, he became entitled to a refund of the 60 cent deposit; that during the time the Receiver operated Debtor's business, the drivers were instructed to give each customer 60 cents, either in credit or cash, for each returned case [R. 143], thus continuing the previous practice of the Debtor. That the Receiver could not pick up a case from a customer *unless the driver gave him the sixty cents*. [R. 143.] That the actual worth of the cases and empty bottles was approximately \$1.80, and therefore it was more advantageous to refund the 60 cents than to permit the case and bottles to remain with the customers [R. 143]; and that stamped upon each case was a legend concerning the 60 cent deposit. [R. 146.]

- Wolf Wilder, also a witness for the Receiver and connected with Wil-Rud, testified that upon each delivery slip or invoice given to customers there was the name of Yankee Doodle Root Beer Company, the customer's name, the words "fulls, medium or small," and "empties, large, medium, small," and a notation, "Charge customer for amount of fulls less the amount of empties returned," and the "net amount to be paid in cash is to be charged." [R. 155.] That upon each wooden case there was stamped a round circle with the word "deposit" half way around it, and "60¢" burned in the wood. [R. 156.]

Sam Rudolph also was called as a witness by the Receiver and testified that he had examined page 88-A of

the inventory containing an item consisting of bottles and cases, and that this item had never been delivered to Wil-Rud by the Receiver. [R. 169.] Page 88-A of the inventory reads as follows:

“Alleged to be in the vicinity or territory of Los Angeles, California.

74,640 root beer bottles 7 oz. 518.13 Gross

5.80\$ 3,006.33

634,708 root beer bottles 10 oz. Gross 6.11.. 26,930.87

25,807 wood shells (hold 24 each) each

.699 18,039.09

Above figures received from Mr. Leo Brill on August 13, 1947.” [R. 170.]

(Mr. Brill therein referred to is an appellee herein.)

During the course of this hearing the Referee stated:

“I wish you would bear in mind, gentlemen, that I am not going to let anybody buy something in this court and then pay for something he doesn’t get.

Mr. Levinson: I quite agree with Your Honor in that regard. No one should have to pay for anything they don’t get. * * *.” [R. 133.]

The Referee, after due consideration of the evidence and objection to the compromise, stated:

“I think this compromise is fair. I don’t think any man ought to be required to pay for anything he doesn’t get. He had a right to rely upon the inventory prepared. So I will approve this compromise.” [R. 167.]

The objecting creditors (appellees) offered no evidence at said hearing. On February 26, 1948, the Referee filed Findings of Fact and Conclusions of Law and Order Approving Compromise.⁷ [R. 24.] On March 8, 1948, cer-

⁷These Findings and Order are summarized, pp. 11 and 12 of this brief.

tain creditors (appellees) filed the Petition for Review.⁸ [R. 25-28.] Thereafter, the Referee filed his Certificate on Review⁹ [R. 29-36], wherein, among other things, he stated the following: That creditors petitioning for review had requested the Court to accept a bid of \$135,000.00 for the assets on behalf of one Miller (previously approved by Creditor's Committee), and not to permit competitive bidding [R. 29-30]; that the Referee opened the matter for competitive bidding and Wil-Rud purchased the assets for \$161,000. That at a hearing on November 7, 1947, it appeared from the evidence that Wil-Rud had submitted its bid in reliance upon an inventory admittedly shown by Receiver's agent to Wil-Rud's representative before the sale [R. 31]; that the inventory shortages amounted to \$18,952.16, and the Referee indicated he would rule that the purchase was made pursuant to the inventory, and would make a pro-rata allowance. At said hearing it was brought to the Referee's attention that certain wooden cases could not be delivered to Wil-Rud free and clear. [R. 31.] That at the hearing on the petition for compromise evidence was received, and the Referee was convinced that Wil-Rud had relied upon the inventory handed it in preparation for bidding upon the assets [R. 33]; that the assets had been sold free and clear, and that there was a strong possibility that Receiver could not deliver clear title to the wooden cases without refunding 60 cents per case to distributors who had a lien for said sum by virtue of possession. That under all circumstances, considering the legal, equitable and practical problems, the possibility of adverse ruling, the ex-

⁸This Petition is summarized, pp. 13 and 14 of this brief.

⁹This Certificate on Review is summarized, pp. 14 to 18 of this brief.

penses of litigation, the proposed compromise should be accepted, and was ordered. [R. 34.] On December 16, 1948, the District Judge rendered a Memorandum Opinion [R. 37], and on May 26, 1949, filed Findings of Fact, Conclusions of Law, and Order reversing the Referee's Order and rejecting the compromise. [R. 44-48.]^{9a}

C. Questions Involved.

1. Did the District Court err in granting the Petition for Review and reversing the Referee's Order Approving Compromise?

2. Did the record on Review disclose a clear abuse of discretion by the Referee in approving the compromise so as to justify the District Court in granting the Petition for Review and reversing the Referee's Order?

3. Did the District Court, upon a Petition for Review from the Referee's order approving a compromise, err in determining the issues involved in the *merits* of the controversy between Receiver and appellant, thereby depriving appellant of its day in Court, upon the merits of the controversy?

4. Did the District Court, upon the Petition for Review, err in trying the factual questions *de novo*, and in rejecting the Referee's findings, and the Referee's determinations as to the credibility of witnesses and the weight be accorded to the evidence?

5. Is the Order of the District Court reversing the Referee's Order supported by the evidence?

6. Is the Order of the District Court reversing the Referee's Order contrary to the evidence.

7. Are the material Findings of Fact of the District Court supported by the evidence?

^{9a}These Findings are summarized, pp. 19 to 21 of this brief.

8. Are the material Findings of Fact of the District Court contrary to the evidence?

9. Did the District Court err in applying the doctrine of "*caveat emptor*" to appellant where the Order of Confirmation of Sale expressly provides that the property sold included, among other things, "all inventory" and "all other physical assets of Debtor corporation wheresoever situated," and that "all of said items are sold free and clear of any liens, charges and incumbrances"?

10. Was the District Court entitled to apply, and did it err in applying the "*caveat emptor*" doctrine, as aforesaid, upon the Petition for Review involved herein?

11. Did the District Court err in holding that there were no liens or charges against the various wooden cases where the undisputed evidence shows the customer had made a 60 cent deposit with the Debtor for each wooden case and bottles, and were entitled to retain possession of such cases until the 60 cent deposit per case was refunded, either in cash or by a credit?

12. Was the District Court entitled to hold, and did it err in holding that there were no liens or charges upon the wooden cases in the possession of customers, as aforesaid, upon the Petition for Review involved herein?

13. Did the District Court err in holding that appellant's efforts to show that the Receiver did not comply with the terms of the Order of Confirmation of Sale by failing to deliver all inventory items purchased, and by failing to deliver certain property "free and clear," constituted a collateral attack upon such Order?

14. Was the District Court entitled to make, and did it err in making such a determination regarding "collateral attack," as aforesaid, on the Petition for Review involved herein?

Specification of Errors.

1. The District Court erred in granting the Petition for Review, and in reversing the Referee's Order Approving Compromise between Receiver and appellant and in denying said petition.

2. The District Court erred in determining on the merits the issues involved in the controversy between the appellant and Receiver upon the Petition for Review from the Referee's Order approving the compromise, as those issues were not before the Court for determination upon the Petition for Review, and its determination thereof deprived appellant of its day in Court on the issues involving the merits of the controversy.

The District Court, in granting the Petition for Review, reversed the Referee's Order and denied the compromise, and determined upon the merits the controversy between the Receiver and appellant, thereby depriving appellant of its day in Court on those issues. The District Court could not determine those issues upon the Petition for Review.

3. The District Court erred in trying on the Petition for Review the factual questions *de novo* and in rejecting the Referee's Findings, the Referee's determinations as to credibility of witnesses and the weight he accorded to the evidence.

The Findings of the District Court state [R. 45]:

"The Court cannot adopt the Findings of the Referee in this matter and therefore finds: . . ."

and affirmatively show that the District Court rejected the Findings of the Referee and tried the factual questions involved *de novo*. In making its findings of the facts, the District Court disregarded and rejected the Referee's determination regarding the credibility of the various wit-

nesses, and the weight which he accorded the evidence. The District Court rejected all evidence, accepted and believed by the Referee, which without conflict showed that prior to the sale Receiver's agent had submitted to Wil-Rud's representative an inventory [R. 86, 99, 168], and told Wil-Rud's representative that an adjustment would have to be made as to items which had been used in the operation of the business [R. 89]; that Will-Rud made its bid in reliance upon the inventory; that it was warranted in relying upon it [R. 99-100, 31, 33, 107]; that there was a shortage of inventory items in the sum of \$18,952.16 [R. 81, 83, 87, 89]; that the Referee, after a hearing, stated he would rule that the purchase was made in reliance upon the inventory shown to Wil-Rud's representative. [R. 31, 33, 107, 112.] The District Court also apparently disregarded evidence to the effect that it was the custom and practice of Debtor and Receiver, while operating the business, to charge a 60 cent deposit for each wooden case, and to refund the 60 cent deposit per case to the customer, either by a credit or in cash, and the Receiver's records so indicated [R. 124-130, 142-143]; that the Referee was convinced that the Receiver could not deliver the cases free and clear without refunding the 60 cent per case deposit to customers, who by virtue of possession held a lien upon said cases [R. 32, 34]; that considering the expenses and uncertainty of litigation, and the problems involved, it appeared to the Referee that the compromise was for the best interests of the creditors. [R. 34.] The District Court, in its Findings, also utterly disregarded the terms and provisions of the Order of Confirmation of Sale [R. 4], the Referee's construction of and weight given to the evidence; and Referee's determination that Wil-Rud's bid was made in reliance upon the inventory, and that it was justified in relying thereon.

[R. 31, 33, 100, 107, 112, 133.] The District Court on this Petition for Review could not reevaluate and reweigh the evidence, or disregard testimony of witnesses given credence by the Referee, or give to the evidence an entire different weight than that given to it by the Referee, or draw inference or deductions therefrom contrary to those which the Referee had made.

4. The District Court erred in making the following portion of Finding No. 1, as follows:

“ . . . A bidder offered \$160,000 and thereupon a bid of \$161,000 was made on the same terms by the Wil-Rud Corporation ‘for all of the outstanding shares of Yankee Doodle Root Beer Company and for the physical assets of California Associated Products . . . ’ . . . ” [R. 45.]

in that said Finding is not supported by the evidence, and is contrary thereto, and finds upon an immaterial matter, as rights and obligations of appellant and Receiver are fixed by the Order Confirming Sale, and not by the bid.

The evidence shows that a bid of \$160,000.00 was for “all of the outstanding shares of Yankee Doodle Root Beer Company” and “for the physical assets of California Associated Products” and for all trade names, trade marks, all formulas, and registered trade names, and lessee’s interest in the lease, including all understandings which any officers of Debtor had with landlord regarding a renewal, or extension of the lease, and the insurance on a pro-rate basis. The only exclusions mentioned were merchandise held by the Bank of America as security, cash on hand, accounts and notes receivable, and deposits. Title to the property was to be delivered free and clear, except as to the water softener. [R. 51-53.] The Order of Confirmation of Sale provided that the Receiver sold to

Wil-Rud all machinery, fixtures, equipment, *all inventory*, all lessee's improvements, all furnishings, all supplies, all finished and unfinished products of every class, character and description, together with all other physical assets of the Debtor corporation, wheresoever situated, together with all of the physical assets of every kind and character of the Yankee Deedle Root Beer Company, a corporation; that all of said items were sold free and clear of any liens, charges, and incumbrances. [R. 4-5.] The evidence further shows that an inventory furnished by Receiver was presented to Wil-Rud's representative before the sale, that Wil-Rud made its bid in reliance thereon and was told that any shortages would be adjusted. (See evidence under succeeding Specification of Errors.) There never was any evidence offered, or statements made, that merchandise sold or used was to be excluded.

5. The District Court erred in making the following portion of Finding No. 2, reading as follows:

“ . . . That said inventory does not purport to be other than an inventory made as of July 28, 1947. That this fact was made known to all bidders. That at the time of the sale the said assets were offered ‘as is’ and without any warranty as to quantity or quality and without any reference to any inventory. That immediately after the confirmation of the sale, the assets so sold were delivered to the Wil-Rud Corporation. . . .” [R. 46.]

in that said Finding is unsupported by the evidence and is contrary thereto.

The sole and only evidence upon that issue is as follows: Ralph J. Yates, Receiver's representative, testified that shortly before the sale he had delivered an inventory of the assets to Samuel C. Rudolph, Wil-Rud's represen-

tative, and had given it to other bidders [R. 86-87]; that both the Debtor and Receiver had been operating the business and he told Rudolph "naturally there would be adjustments on the merchandise that had been used in connection with the operation of the business." No specific items were mentioned [R. 89]; that after the sale was confirmed, a physical check by Receiver's and Wil-Rud's representatives had been made of the merchandise delivered against the inventory, and the shortages had been indicated upon a statement [R. 81-83], which he checked. [R. 86.] Samuel C. Rudolph testified that about ten days before the sale he went to Debtor's place of business and was handed an inventory by Receiver's representative; that he was told that the only thing sold from the inventory was some Monterey Grape Juice; that no claim for shortages was made for that item. [R. 99.] That shortages could not be determined by an inspection of the plant; that for years he had purchased merchandise at Receiver's and Trustee's sales, and found that he could rely upon inventories given to him by Receivers or Trustees, and that shortages were always adjusted. [R. 100.] The undisputed evidence shows that some time after the sale, the goods delivered were checked by representatives of Wil-Rud and Receiver against the original inventory, and that the shortages were listed upon a document entitled, "Inventory Shortages at California Associated Products, Inc." [R. 81-83.] The Referee's Certificate states that Wil-Rud had submitted its bid in reliance upon the inventory admittedly shown its representative [R. 31]; that the purchaser had relied upon the written inventory in bidding upon the assets, which were sold free and clear to the purchaser. [R. 33-34.] The Order Confirming Sale states that the Receiver sold to Wil-Rud cer-

tain described property, including "all inventory," together with "all of the other physical assets of the Debtor corporation, wheresoever situated," and that "all of said items are sold free and clear of any liens, charges and incumbrances." [R. 5.] Even the original bid of \$135,000 by Miller indicated that title was to be delivered "free and clear," except the water softener. [R. 53.] All property described in the Order Confirming Sale was never delivered to Will-Rud; the shortage, described on Petitioner's Exhibit 1 [R. 81-83], amounted to \$18,952.16. Upon page 88-A of the inventory submitted to Wil-Rud's representative before the sale, there was an item representing 25,807 wooden cases. The inventory contained nothing indicating that this item was subject to a 60cent deposit per case. [R. 127.] This deposit had to be refunded when the empty cases were returned, either in cash or by credit. [R. 133, 142, 143.] The Referee's Certificate on Review states that the wooden cases and bottles involved could not be delivered free and clear to purchaser because retail distributors had possession of the wooden cases and bottles involved, and had paid a 60 cent deposit per case; and therefore had a lien for said amount predicated upon possession of the cases. [R. 32.]

There is no evidence that the sale of assets was made "as is" and without any warranty as to quantity or quality, and without any reference to inventory. It is all to the contrary.

6. The District Court erred in making the following Finding of Fact, being Finding No. 4, reading as follows:

"4. That said sale was not made on the basis of a sale of the assets as reflected in the receiver's inventory as of the close of business on July 28, 1947, nor was the bid of Wil-Rud so made." [R. 46-47.]

in that said Finding is not supported by the evidence and is contrary thereto.

The undisputed testimony shows that Yates, Receiver's representative, gave to Wil-Rud's agent a copy of the Receiver's inventory about ten days before the sale [R. 86-87], and stated that adjustments would have to be made on the items used. [R. 89.] Rudolph testified that he was given the inventory but could not, from an inspection of the plant, discover any shortages [R. 99]; that he was told the only shortage was some Monterey Grape Juice, for which no claim has been made. [R. 99.] That for years he had purchased at bankruptcy sales, and found he could always rely on inventories given him by Trustees or Receivers, and that shortages always were adjusted, and that he made his bid based upon the inventory submitted to him. [R. 100.] The Referee's Certificate states that Wil-Rud had submitted its bid in reliance on the inventory admittedly shown to its representative. [R. 31.] That this inventory was presented to the Court in evidence. [R. 31.] That after a hearing the Referee was convinced that Wil-Rud had relied upon the inventory in making its bid [R. 33]; that he would rule that the purchase was made pursuant to the inventory. [R. 31.] At this hearing the Referee stated to appellant, "They wouldn't give you a long document, or even make it up, if they didn't expect you to rely on it." [R. 107.] The Order Confirming Sale expressly includes "all inventory."

7. The District Court erred in making the following Finding, being Finding No. 5, reading as follows:

"5. That the said Wil-Rud Corporation was not warranted in relying upon nor did it rely upon the inventory in making said bid. That it was not in the best interests of creditors that the said proposed compromise be ordered." [R. 47.]

in that said Finding is not supported by the evidence and is contrary thereto.

The undisputed evidence shows that Yates, Receiver's representative, testified that shortly before the sale he had delivered an inventory of assets to Rudolph, Wil-Rud's representative, and had given it to other bidders [R. 86-87]; that both Debtor and Receiver had been operating the business, and he told Rudolph "naturally there would be adjustments on the merchandise that had been used in connection with the operation of the business." No specific items were mentioned. [R. 89.] Rudolph testified that about ten days before the sale he went to Debtor's plant and was handed an inventory by Receiver's representative, and was told that only some grape juice had been sold [R. 99]; that an inspection of the premises could not disclose any shortages; that he relied upon the inventory in making the bid for Wil-Rud; that he found that from 35 years of purchasing at bankruptcy sales that he could always rely on the inventory of the Trustee or Receiver in making a bid, and that if there were any shortages, the same would be adjusted. [R. 100.] The Referee at the hearing on November 7, 1947, stated to Wil-Rud's attorney, "They wouldn't give you a great long document (inventory), or even make it up if they didn't expect you to rely on it" [R. 107], and in his Certificate on Review noted that Wil-Rud had submitted its bid in reliance upon the inventory shown its representative [R. 31]; that at a previous hearing he (Referee) had indicated that he would rule that the purchase had been made pursuant to the inventory, and that a pro-rata allowance for shortages would be made [R. 31]; that he (Referee) was convinced that the purchaser (Wil-Rud) had relied upon the written inventory handed to its agent in preparation for bidding on the assets. [R. 33.] The Referee further

stated that the property had been sold free and clear to the purchaser. [R. 34.] The Order Confirming Sale also included among the assets sold "all inventory" [R. 4], and stated the items were sold free and clear of any liens, charges and incumbrances. [R. 5.] The original Miller bid provided that the property be free and clear. [R. 53.] The evidence showed that the inventory did not indicate that the 25,807 wooden cases and bottles were subject to 60 cent deposits [R. 127]; that the distributors had been charged a deposit of 60 cents per case when they received the cases, and received a refund of 60 cents when the empties were returned [R. 142-143]; that the liability of the deposits upon the cases would run over \$16,000.00. [R. 125.] The shortages were \$18,952.16. [R. 81-83.] Before the Receiver could deliver the cases to Wil-Rud free and clear of all claims, liens and incumbrances, it appeared to be necessary for the Receiver to quiet title to the cases or to make the refunds. [R. 34, 23.]

The evidence shows that it was for the best interest of the creditors to compromise the claims of Wil-Rud. The inventory shortages amounted to \$18,952.16 [R. 81-83]; the liability for the 60 cent deposit on the cases ran over \$16,000.00; Wil-Rud logically could claim from the Receiver a sum in excess of \$28,500.00. [R. 125.] Besides, Wil-Rud agreed to hold the Receiver harmless from refunds of the 60 cent deposits [R. 19, 22], and the Receiver avoided the cost, expenses, and necessity of legal proceedings to quiet title to thousands of cases in the hands of customers. [R. 34.] Under the compromise, the Receiver benefited by and saved over \$10,000.00 from the amount Wil-Rud reasonably could claim, and the Receiver avoided litigation and expense with the customers holding the empty cases. The compromise reduced the purchase price to \$142,500.00, more than \$7,500.00 above

the bid of \$135,000.00 originally submitted by Miller, and *approved by the Creditor's Committee, with a request that the Referee accept the same and direct the Receiver to sell the assets for said amount without competitive bidding.* [R. 51-54.] The objecting creditors offered no evidence whatsoever that the proposed compromise was not for the best interest of creditors.

8. The District Court erred in making Conclusion of Law No. 2, reading as follows:

“2. That the within proceedings cannot be maintained as a collateral attack upon the Referee's order of sale dated October 22, 1947.” [R. 47.]

in that the Petition for Leave to Compromise was not a collateral attack upon the Order Confirming Sale dated October 22, 1947, and that such conclusion is contrary to law, and contrary to and not supported by the evidence.

The District Court overlooked the *undisputed* evidence that Wil-Rud made its purchase in reliance upon an inventory admittedly shown to it by Receiver's agent; that there was a shortage of inventory items amounting to \$18,952.16; that the property was sold free and clear of any liens, charges and incumbrances, and that certain wooden cases were not “free and clear.” That the terms and provisions of the Order Confirming Sale which specifically described the property sold, including therein “all inventory” and “all other physical assets wheresoever located” and that said items were sold “free and clear of any liens, charges, and incumbrances,” *and made payment concurrent with delivery* of the assets. The dispute arose out of the Receiver's failure *to comply* with the express terms of said Order Confirming Sale. It was for the Referee to determine whether the Receiver *had complied* with the Order Confirming Sale, and to do so was not a

collateral attack upon the order. If there was no compliance by Receiver, Wil-Rud then was entitled to an *abatement* in the purchase price.

9. The District Court erred in making Conclusion of Law No. 3, reading as follows:

“3. That the equities herein are not with the purchaser in that there was a bid of \$160,000 which was rejected because said Wil-Rud Corporation increased said bid by \$1,000; that said bid of \$160,000 was for the assets as they then existed and not with the qualifications or restrictions now insisted upon by said Wil-Rud Corporation. That the creditors of this bankrupt will suffer a loss of \$18,500 if the order of compromise is finally approved.” [R. 47-48.]

in that the same is contrary to law and is contrary to, and is not supported by the evidence.

Such conclusion overlooks the evidence disclosing that Wil-Rud's bid was made pursuant to and in reliance upon the Receiver's inventory admittedly given to Wil-Rud's agents prior to the sale [R. 86-87] with the statement that if there were missing items, the same would have to be adjusted. [R. 89.] At a hearing the Referee stated that he would rule in favor of Wil-Rud on the shortages [R. 112, 31]; and stated in his Certificate that Wil-Rud had relied upon the inventory in making its bid. [R. 31.] This was shown to Wil-Rud for the purpose of relying thereon. [R. 107.] The undisputed evidence shows \$18,952.16 shortages [R. 81-83]; that over 25,000 wooden cases were subject to deposits of 60 cents per case in favor of customers who by virtue of possession had a lien to the extent of the deposits. [R. 32, 34, 133, 142, 143.] The Order Confirming Sale included “all inventory” and “all other physical assets wheresoever located” and that

all items were sold "free and clear of any liens, charges and incumbrances." It was for the Referee to determine the meaning of those terms, and whether there had been a compliance therewith. The evidence further showed that the Creditor's Committee, including appellee creditors, had recommended a bid of \$135,000 and had requested the Referee to accept it, and direct Receiver to sell at said figure *without* competitive bidding. [R. 29, 30, 52, 53, 54.] The compromise was \$7,500 in excess of *this* bid. Besides, under the compromise appellant was to hold the Receiver harmless from any claims of the 60 cent per case refunds. There is no evidence that the \$160,000 bid was for the assets as they then existed. The bid made certain exclusions [R. 53] which did not include missing items or shortages.

10. The District Court erred in making Conclusion of Law No. 4, reading as follows:

"4. That said Wil-Rud Corporation did not dis-affirm the sale but took possession of the assets and cannot in this manner attack the sale; and said Wil-Rud Corporation is bound by the rule of *caveat emptor*." [R. 48.]

in that the same is contrary to law, and contrary to and not supported by the evidence.

This conclusion of law overlooked the undisputed evidence that the property was purchased in reliance upon an inventory admittedly shown Wil-Rud's agent by Receiver's representative [R. 86-87]; and that adjustments would be made [R. 89]; that the Order Confirming Sale included in the property sold "all inventory" and "all other physical assets wherever situated," and that all items were sold "free and clear of any liens, charges and incumbrances," and made payment concurrent with delivery of

all assets. [R. 4-5.] Appellant claimed that Receiver had not delivered all property in accordance with and as provided by the terms of said Order. [R. 12.] The question was whether the Receiver had complied with the Order. The Order Confirming Sale contained *express warranties*; and by reason of the representations by Receiver's agent, the rule of *caveat emptor* was not applicable. After the Referee had interpreted the Order and had determined that Receiver had not complied therewith, Wil-Rud was entitled to a credit, the amount of which was a proper controversy to compromise. Under the circumstances the Referee was justified in ordering the compromise.

11. The District Court erred in making Conclusion of Law No. 5, reading as follows:

"5. That there is no evidence that anyone has ever claimed a lien against the property purchased by said Wil-Rud Corporation from the receiver, other than the conditional sales contract holder specifically mentioned in the order confirming the sale to Wil-Rud Corporation." [R. 48.]

in that the said conclusion is contrary to law and contrary to, and not supported by the evidence.

This conclusion overlooks the undisputed evidence that a 60 cent deposit had been made by customers on each wooden case when they purchased the product, during the time Debtor and Receiver operated the business [R. 129, 133, 142]; that such customers were entitled to a refund of this deposit [R. 142-143]; *that an empty case could*

not be picked up from the customer unless the driver gave him 60 cents [R. 143]; that such was the practice of both Debtor and Receiver. [R. 143.] That no specific person made a "*claim of lien*" is immaterial and did not extinguish any lien or adverse claim against empty cases; they claimed the 60 cent deposit, and the empty case could not be taken from the customer "unless the driver paid him sixty cents." [R. 143.] A lien dependent upon possession existed and was not extinguished as long as the obligation to refund remained.

12. The District Court erred in making the following Order:

"Therefore, for the reasons as set forth herein, the Order of the Referee dated February 26, 1948, affirming the Receiver's compromise whereby he credited to the Wil-Rud Corporation the amount of \$18,500 upon its purchase price of \$161,000 should be and the same hereby is reversed and set aside, and said petition to compromise denied." [R. 48.]

in that said Order is contrary to law, and is contrary to and not supported by the evidence.

Summary of Argument.

The headings on our argument have been prepared so that they may serve as a summary. Accordingly, we incorporate by reference the index of the argument appearing at the commencement of this brief as our summary of the argument.

ARGUMENT—POINTS AND AUTHORITIES.

I.

The District Court Erred in Reversing the Referee's Order Approving the Compromise as the Record Discloses No Abuse of Discretion Whatsoever by the Referee in Approving the Compromise.

Upon a Petition for Review from a Referee's order approving a compromise, the record *affirmatively* must show a *clear abuse of discretion* by the Referee before the order can be reversed by the District Judge. The record herein is totally *devoid* of any such showing.

Primarily it is appropriate to refer to certain fundamental principles of law controlling the issues involved.

(a) The basic statutory provision involved herein (U. S. C. A., Title 11, Sec. 50; Bankruptcy Act, Sec. 27) reads as follows:

“The receiver or trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate.”

(b) A controversy within the terms of that section is a disagreement or disputatious difference. (*In re Towers*, 27 Fed. Supp. 693.) It implies a dispute to be settled. (*Mueller v. Elba Oil Co.*, 21 Cal. 2d 188, 203, 130 P. 2d 961.)

(c) Jurisdiction to approve a compromise is conferred by the foregoing statute (11 U. S. C. A., Sec. 50), rather than by the General Orders. (*In re L. M. Axel Co.*, 3 F. 2d 581; *Petition of Stuart*, 272 Fed. 938.)

(d) A court of bankruptcy possesses not only the powers of a court of equity to settle controversies between the trustee or receiver and claimants, but has the express authority under the foregoing section to approve such settlement when for the best interest of the estate. (*In re Van Camp Prod.*, 95 F. 2d 206.)

(e) The term "court," as used in the foregoing section, includes the Referee of the court in which the bankruptcy proceedings are pending. (U. S. C. A., Title 11, Sec. 1(9); *Mueller v. Elba Oil Co.*, 21 Cal. 2d 188, 206, 214, 130 P. 2d 961.)

(f) The fairness of the Receiver's compromise of claim is a matter initially for the Receiver and finally for the Referee, the Referee's action being subject only to review for clear abuse of discretion. (*In re Paley*, 26 Fed. Supp. 952.) The fact that the Receiver favors the settlement is entitled to great weight. (*In re Paley, supra.*)

(g) Creditors are entitled to be heard, and to vote, but their action is merely advisory and it is not binding upon the court (*Hair v. Byars*, 92 F. 2d 684; *In re National Public Service Corp.*, 68 F. 2d 859); the final responsibility rests with the Referee to approve or disapprove the compromise. (*In re Paley, supra.*) Where only the objecting creditors are represented at the hearing, a vote is unnecessary. (*In re Paley, supra.*)

(h) The power to "compromise a controversy" is one of the broadest powers conferred by the Bankruptcy Act. Under that power almost anything desirable in the interests of the estate can be accomplished, *even though in ways that otherwise would be irregular.*

In *In re Stuart*, 272 Fed. 938, the Court states:

“ . . . The authority to compromise conferred by §27 of the Bankruptcy Act is in terms unlimited:

‘The trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interests of the estate.’

The section clearly does not limit the right of compromise to controversies in which all creditors have the same interest.”

In the *Matter of Anderson Thorson & Co.*, 125 F. 2d 325, the Court states:

“This provision has been generally construed as lodging a broad discretion in the District Courts in the compromise of bankruptcy controversies, and reviewing courts have refused to interfere with such discretion except upon a clear showing of abuse.”

(To same effect: *In re Niagara Falls Milling Co.*, 34 Fed. Supp. 801; *In Matter of Prudence Co., Inc.*, 98 F. 2d 559; *Scott v. Jones*, 118 F. 2d 30; *In re Riggi Bros. Co.*, 42 F. 2d 174; 2 Rem. on Bkcy. 720; *Mueller v. Elba Oil Co.*, 21 Cal. 2d 188, 130 P. 2d 961.)

(i) The order of the Referee approving a compromise can be set aside upon Review *only* by a showing of a clear abuse of discretion by the Referee, and not by showing that he may have erred in correctly anticipating the ultimate result of pending or threatened litigation. The very purpose of a compromise is to avoid the determination of sharply contested and dubious issues. The approval of a compromise is addressed to the sound discretion of the Referee, and his action thereon can be disturbed on Review only where the record shows a *clear abuse of discre-*

tion. This is true even where the order approves a compromise of a doubtful claim.

In *Matter of Prudence Co., Inc.*, 98 F. 2d 559, the Court states:

“It is conceded, as it must be under the authorities, that the approval of a compromise of a claim against a bankrupt’s estate is a discretionary order which can be reversed only for an abuse of discretion.”

In *Scott v. Jones*, 118 F. 2d 30, the Court states:

“An order approving a compromise of a doubtful claim involves the discretionary powers of the court and may be disturbed only when it clearly appears that such discretion has been abused.”

To same effect: (*Matter of Anderson Thorson & Co.*, 125 F. 2d 325; *In re Riggi Bros. Co., Inc.*, 42 F. 2d 174; *Petition of Stuart*, 272 Fed. 938; *Drexel v. Loomis*, 35 F. 2d 800.)

(j) In approving a compromise the Referee *need not, and cannot* determine on the merits the controversy between the parties. It is the very purpose of a compromise to avoid a determination of sharply contested or even dubious issues. The primary factors to be considered are the probabilities of success or failure of litigation; the complexities of the litigation involved, or threatened, and the expense, delay and inconvenience of litigation. It is not the duty or province of the Court to make an actual determination on the merits of the controversy involved.

In *In re Riggi Bros. Co., Inc.*, 42 F. 2d 174, a leading case, the Court states:

“[1, 2] The approval of this compromise settlement is not to be tested wholly by what may now be

thought would have been the result of litigation to settle the respective claims of the parties. It is certain that litigation for that purpose would have been the inevitable result of a failure to compromise and equally certain that it would have made for delay and expense. This should be kept in mind in reviewing the approval of the compromise. *Petition of Stuart (C. C. A.)*, 272 F. 938-941. Coupled with the certainty of litigation was the uncertainty of its result and the soundness of the exercise of discretion in approving it largely depends upon how substantial was this element of uncertainty. The action of the District Court is presumptively right, and will not be set aside unless clearly shown to have been wrong. *Pullman Couch Co. v. Eshelman (C. C. A.)*, 1 F. (2d) 885, 887, 888. Consequently, we shall make no attempt to decide with exactness what would have been the outcome had no settlement been made and approved. Any virtue which may reside in a compromise is based on doing away with the effect of such a decision. For present purposes it is enough to consider only what was reasonably to be expected to happen had no agreement been made. . . .

We do not decide what effect, if any, this Vermont statute would have had on the validity of the mortgage. It is quite enough now to know that the trustee would have met with serious opposition in trying to free the property from the mortgage lien. While he might, perhaps, have succeeded, the nature of the legal problems involved was such that the expense, delay and likelihood of failure may well have made a compromise settlement advisable."

In *Matter of the Prudence Co., Inc.*, 98 F. 2d 559, the Court states:

“The District Court did not determine the validity of the government’s claim with respect to the taxability of the ‘commissions’; nor need this court do so. The very purpose of a compromise is to avoid the determination of sharply contested and dubious issues, . . .”

The Supreme Court of California, in *Mueller v. Elba Oil Co.*, 21 Cal. 2d 188, states:

“Under this section the bankruptcy court had power to dispose of claims or assets of the bankrupt, of doubtful value, in an expeditious manner, other than in the usual and ordinary manner . . .

In connection with the attack on the compromise proceedings, it is asserted that the trustee was entitled as of course to compel the defendants to marshal their assets, and on that premise plaintiff contends that there was no controversy to compromise. Such contention is devoid of merit; substantially every fact disclosed in connection with the proceeding to marshal assets and to compromise the same belies it. The mere fact that the trustee had the right as of course to maintain the proceedings did not make the fact or amount of net recovery for the partnership estate any less controversial. The trial court in bankruptcy (the referee) had the right to consider the uncertainty and cost of litigation in determining the advisability of compromise (*Petition of Stuart*, (1921, 6 Cir.) 272 F. 938, 941). . . .”

In *Matter of Anderson Thorson & Co.*, 125 F. 2d 325, the Court states:

“Furthermore, we, as well as the District Court, are powerless in the instant situation to review the proceedings of that case. In fact, any error committed is irrelevant to the present question except as it might enter into the court’s appraisal as to whether a compromise was better for the estate than the dubious result which might be achieved by appeal.”

(To same effect: *Petition of Stuart*, 272 Fed. 938; *Drexel v. Loomis*, 35 F. 2d 800.)

It is a cardinal rule that a Referee speedily should dispose of litigation on behalf of the bankrupt estate, involving delay and expense. (*Scott v. Jones*, 118 F. 2d 30.)

Fortified with the foregoing principles of law it appears that the basic question (and only one) which the District Court could determine upon the Petition for Review was whether there was a clear showing that the Referee, in approving the compromise between the Receiver and Wil-Rud, had abused his discretion.

Viewed against the backlog of surrounding circumstances, it clearly appears that no abuse of discretion by the Referee was shown, and that the reversal of the Referee’s Order Approving Compromise by the District Court was and is clearly erroneous. The evidence clearly shows that the Receiver’s representative admittedly had delivered an inventory of assets to Rudolph, Wil-Rud’s representative, shortly before the sale, and had given it to other bidders [R. 86-87]; that the business had been operated by Receiver, whose representative stated to Rudolph, “naturally there would be adjustments on the merchandise that had been used in connection with the operation of the

business.” No specific items were mentioned. [R. 89.] Wil-Rud’s representative was given the inventory about ten days before the sale and from an inspection of the plant could not discover any shortages, and was told that the only shortage was some grape juice. [R. 99.] At the sale a certain Miller bid of \$135,000 was read to the Referee “for all outstanding shares of Yankee Doodle Root Beer Company and for the physical assets of California Associated Products,” including all trade names, trade marks, formulas, registered trade names, lessee’s interest in the lease, and insurance on a pro-rata basis, which excluded only the security held by the Bank of America, cash on hand, accounts and notes receivable and deposits. Title to the said property was to be delivered free and clear, except a water softener. *No other exclusions were mentioned.* [R. 51-53.] The Referee was advised that the Creditor’s Committee had approved this bid and requested that it be accepted and that the Receiver be directed to sell without competitive bidding. [R. 29, 30, 53, 54.] Wil-Rud purchased all the assets for \$161,000 [R. 30, 68] free and clear of all liens, charges and incumbrances [R. 4, 53]; and the Referee’s Order Confirming Sale provided that the Receiver sold “all inventory,” together with “all other physical assets . . . wheresoever situated,” “free and clear of any liens, charges and incumbrances.” [R. 4-5.] After confirmation the assets delivered were checked against the items on the original inventory by representatives of Receiver and Wil-Rud [R. 84-86], and the shortages were indicated upon a statement [R. 81-83] amounting to \$18,952.16. Thereafter disputes arose between Receiver and Wil-Rud; a hearing was had before the Referee [R. 72-113], and evidence disclosing the foregoing was adduced as well as

that showing that Rudolph had purchased goods at bankruptcy sales for many years and always could rely upon Receiver's and Trustee's inventories, and that any shortages were *always* adjusted. [R. 100.] The Referee at this hearing stated that the inventory never would have been shown to Wil-Rud's representative, or even prepared "if they did not expect you (Wil-Rud) to rely on it" [R. 107], and that "I think a man ought to get what he buys, what he bids for. If he doesn't get it he should not pay for it" [R. 112]; and directed an order to be prepared accordingly. [R. 112.] The Referee's Certificate on Review states that Wil-Rud had submitted its bid in reliance upon the inventory admittedly shown its representative [R. 31]; that after the hearing of the evidence, the Referee was convinced that Wil-Rud had relied upon the inventory in making its bid [R. 33]; that he (the Referee) would rule that the purchase had been made pursuant to the inventory. [R. 31.] At this hearing the Referee's attention also was directed to the 60 cent deposits on thousands of wooden cases in the possession of customers which Wil-Rud had purchased "free and clear." [R. 112.] It was then suggested that Wil-Rud and Receiver attempt to adjust the matters, and if this could not be done, then appropriate proceedings would be commenced. [R. 113.] The evidence at the hearing on the Petition to Compromise disclosed that there was an item on page 88-A of the inventory representing 25,807 wooden cases with nothing to indicate that those cases were subject to a deposit of 60 cents per case paid by customers to the

Debtor [R. 127], and Receiver had not delivered this property to Wil-Rud "free and clear." [R. 169.] It was necessary to refund this deposit when empty cases were returned [R. 133, 142, 143]; that an empty case could not be picked up from the customer unless the driver gave him the 60 cents [R. 143]; that this had been the practice of both the Debtor and Receiver while operating the business. [R. 143.] The liability of the Receiver on the deposits could run over \$16,000. [R. 125.] The Order Confirming Sale provided that all items were sold "free and clear of any liens, charges and incumbrances." [R. 5.] The Referee's Certificate on Review stated that the property had been sold free and clear, and that by reason of said deposits there was a strong possibility that the Receiver could not deliver clear title to the wooden cases and bottles involved without compensating the customers to the extent of 60 cents per case, as the customers had possession of the cases and appeared to be entitled to a lien thereon until the 60 cent deposit was returned. In addition thereto the Referee stated that there was the practical problem of quieting title to many thousands of wooden cases located in the hands of many thousands of customers. [R. 34.] All of the foregoing was before the Referee when he considered the advisability of the compromise. The Receiver was faced with a dilemma. The Referee previously had indicated that he would rule adversely to the Receiver upon the inventory shortages. Such a ruling admittedly would have entitled Wil-Rud to relief. It could have rescinded the sale, or it was entitled

to an abatement of a part of the purchase price, which the Referee had indicated he would allow. The Order Confirming Sale provided that payment was *concurrent* with delivery of all assets to Wil-Rud. The Receiver was required to deliver 25,807 wooden cases wheresoever situated, "free and clear," which were subject to deposits. To comply with the Order, a myriad of proceedings would have to be instituted by Receiver against customers who had paid a deposit of 60 cents per case to the Debtor, and having possession of the cases, in equity and good conscience, could assert a lien upon, or possessory rights to the cases until the deposit was returned; or they could assert refund claims or offset rights against the Receiver's estate. This liability could well exceed \$16,000. No one could foretell with certainty the results of litigation between the customers and Receiver. The cost of such litigation involved a long delay, tremendous work and expense, and ultimately the Receiver probably would have to repay the deposits before he could deliver the cases to Wil-Rud "free and clear." Wil-Rud was willing to hold the Receiver harmless from these deposit refunds. Furthermore, the Referee had indicated a ruling adverse to the Receiver upon the question of inventory shortages. All these were matters which the Receiver, and ultimately the Referee, had to consider in determining whether the compromise was "for the best interests of the estate." *There was no abuse of discretion in approving the compromise. The reversal of the Referee's Order by the District Judge is erroneous.*

II.

The District Court Erred in Determining on the Merits the Controversies Between Receiver and Appellant. This Was Not Proper Upon the Petition for Review of Referee's Order Approving Compromise, as It Was Beyond the Power of the Court, and Deprived Appellant of Its Day in Court on Those Issues.

The District Court determined the existing controversies on the merits. [R. 44-48.] *Upon review* it had neither the right nor power to so do. Those were matters for future litigation, if the compromise failed.

The purpose of a compromise is to avoid the determination of sharply contested and dubious issues. (*Matter of the Prudence Co.*, 98 F. 2d 559; *In re Riggi Bros. Co.*, 42 F. 2d 174, 175.)

The authorities, as well as common sense, dictate that on a petition to compromise the Court can make no determination on the merits of the controversies sought to be compromised, for a decision upon the merits would leave nothing left to compromise. Certainly the District Court reviewing a Referee's order approving a compromise cannot make such a determination.

In the *Matter of Anderson Thorson & Co.* (7 Cir.), 125 F. 2d 325, the objecting creditor contended that it was error to approve a compromise of a judgment, pending an appeal therefrom, before determining the merits of the controversy on the appeal. The Circuit Court rejected such contention, stating:

“Furthermore, we, as well as the District Court, *are powerless in the instant situation to review the proceedings of that case.* In fact, any error com-

mitted is irrelevant to the present question except as it might enter into the court's appraisal as to whether a compromise was better for the estate than the dubious result which might be achieved by appeal." (Italics ours.)

In the *Matter of the Prudence Co., Inc.*, 98 F. 2d 559, it was contended that it was error to approve a compromise of the Government's claim for income taxes before determining the validity of the claim. The Circuit Court answered that contention stating:

"The District Court did not determine the validity of the government's claim with respect to the taxability of the 'commissions'; nor need this court do so. The very purpose of a compromise is to avoid the determination of sharply contested and dubious issues, . . ." (Italics ours.)

In *In re Riggi Bros., Inc.* (2nd Cir.), 42 F. 2d 174, it was contended that it was necessary to determine the validity of the mortgage involved therein before approving any compromise. In answer to that contention the Court stated:

"Consequently, we shall make no attempt to decide with exactness what would have been the outcome had no settlement been made and approved. Any virtue which may reside in a compromise is based on doing away with the effect of such a decision. For present purposes it is enough to consider only what was reasonably to be expected to happen had no agreement been made. . . ."

“We do not decide what effect, if any, this Vermont statute would have had on the validity of the mortgage. It is quite enough now to know that the trustee would have met with serious opposition in trying to free the property from the mortgage lien. . . .” (Italics ours.)

In *Mueller v. Elba Oil Co.*, 21 Cal. 2d 188, it was contended that it was error to approve a compromise as the Trustee, as a matter of law, could have prevailed in another proceeding available to him. The California Supreme Court stated:

“Such contention is devoid of merit; substantially every fact disclosed in connection with the proceeding to marshal assets and to compromise the sale belies it. The mere fact that the trustee had the right as of course to maintain the proceeding did not make the fact or amount of net recovery for the partnership estate any less controversial. . . .”

To same effect: (*Petition of Stuart*, 272 Fed. 938; *Drexel v. Loomis*, 35 F. 2d 800.)

In the instant case the Referee found that Wil-Rud reasonably could contend that it was entitled to an adjustment of \$28,000, but made no actual determination of the existing controversies. [R. 21.] This was correct under the authorities.

The District Court *on review*, however, determined on the merits the existing controversies. This Order was and is beyond the power of the Court and error.

III.

The District Court in Reviewing the Referee's Order Approving Compromise Erred in Trying the Factual Questions De Novo, and in Rejecting the Referee's Findings, His Determination of the Credibility of Witnesses, and the Weight He Accorded to the Evidence.

The District Judge summarily rejected the Findings of the Referee [R. 45] and tried the *factual* questions involved *de novo* as though the matter had been tried before him in the first instant. In so doing the District Judge *on review* erroneously disregarded the Referee's determination as to credibility of witnesses and the weight he accorded to the evidence.

On July 29, 1947, by Order of Reference this entire Debtor Proceedings, out of which this instant matter arose, was referred *for all purposes* to Referee Hugh L. Dickson. [R. 179.] After such general reference, the *power* of the District Court was *strictly one of review*. (*In re Orpheum Circuit* (D. C. N. Y.), 20 Fed. Supp. 101.)

General Order No. 47 (U. S. C. A., Title 11, foll. Par. 53) provides:

"Unless otherwise directed in the Order of reference the report of a referee . . . shall set forth his findings of fact and conclusions of law and the Judge shall accept his findings of fact unless clearly erroneous. . . ."

This Ninth Circuit Court of Appeals in *Powell et ux v. Wumkes*, 142 F. 2d 4, 6, has interpreted General Order 47 and the powers of a District Judge on review. This Court states:

"Where he confines himself to a review of the record made before the referee he is not permitted to

try factual questions *de novo*, that is to say, he is not at liberty to reject the findings of the referee merely because he disagrees with the latter as to the credibility of witnesses or the weight to be accorded conflicting evidence."

The District Court upon review is not justified in disregarding the Referee's findings when based upon substantial evidence. (*Reich v. Industrial Com'r of N. Y.* (2 Cir.), 145 F. 2d 759; *In re Freelove* (D. C. Cal.), 74 Fed. Supp. 666; *Ashton v. Sentney* (9 Cir.), 145 F. 2d 719; *In re Cummings* (D. C. Cal.), 84 Fed. Supp. 65.) Particularly is this so where there is conflicting evidence. (*Powell v. Wumkes* (9 Cir.), 142 F. 2d 4; *In re Nay* (D. C. Cal.), 58 Fed. Supp. 960; *Gentry v. Abbott-Kinney Co.* (D. C. Cal.), 66 Fed. Supp. 841.)

The Court of Appeals when considering findings of the District Court, made on review, contrary to those of the Referee upon matters referred to him for decision, has the same duty as the District Court to accept Referee's findings. (*Phillips v. Baker* (5 Cir.), 165 F. 2d 578; *In re Sandows* (2 Cir.), 151 F. 2d 807.)

The following Referee's Findings, based either upon undisputed substantial evidence, or conflicting evidence, was rejected by the District Court, namely, that Wil-Rud could reasonably claim a total adjustment of \$28,000 against Receiver; that it was for the best interests of the estate to compromise [R. 21]; that the purchaser relied upon the inventory prepared by the estate in making its bid, and was entitled to pro-rata credits for shortages; that it would

be an unwise expense to direct the Receiver to quiet title to approximately 25,000 cases so that Receiver could deliver same to Wil-Rud, free and clear [R. 22-23]; that as a part of the compromise Wil-Rud agreed to hold Receiver harmless from the 60 cent refunds per case. [R. 22.]

The District Court also rejected the following statements in the Referee's Certificate, based upon substantial evidence, and the weight and credence given to it by Referee, namely, that Wil-Rud had submitted its bid in reliance upon the inventory admittedly shown its representative [R. 31, 33]; that after a hearing the Referee had indicated he would rule that the purchase was made pursuant to inventory, and a pro-rata allowance would be made to the bidder [R. 31, 33]; that the physical assets had been sold free and clear to purchaser; that Receiver could not deliver title to the wooden cases without repaying the 60 cent per case to distributors who having possession were entitled to a lien until the refunds were paid [R. 34]; that considering the practical and legal problems involved, the possibility of adverse rulings, the costs, expense and delays of litigation, the compromise was approved. [R. 34.] The District Court, in retrying the practical issues, disregarded the weight and credence given the evidence by Referee, namely the testimony of witnesses Yates, Rudolph, and Wilder, the substance of which, with record references, is fully set forth prior hereto under Specification of Error No. 3.¹⁰ The District Court erred in refusing to accept the Referee's Findings.

¹⁰This specification is found on pages 37 to 39 of this brief.

IV.

The District Court Erred in Applying the Doctrine of Caveat Emptor to Appellant's Purchase. It Was Not Applicable Because (A) of the Express Provisions of Order Confirming Sale; (B) of Representations by Receiver's Agent; (C) of the Referee's Findings; (D) Appellant Was Entitled to Pro-Rata Abatement of Purchase Price for Shortages and Liens; (E) It Was Not Proper Issue on Review.

The District Court's Order [R. 48] erroneously was bottomed upon the doctrine of *caveat emptor*.

The Order Confirming Sale *expressly* provided that Receiver sold certain described property, including "all inventory" and "all other physical assets of Debtor Corporation wheresoever situated," and "that all said items are sold free and clear of any liens, charges and incumbrances." [R. 4, 5.] It further provided "delivery of the assets to be made upon signing of within Order, and *payment* therefor to be made *concurrently with delivery* to buyer." [R. 4.]

A. It is well settled that the doctrine of *caveat emptor* does not apply where the order confirming sale contains express warranties. (6 Rem. Bkrcy. 55; 4 Collier Bkrcy. 1588.)

The provisions of the Court's decree are controlling and the parties rights and obligations are fixed thereby. The purchaser is protected by the order or decree of Court.

In *In re United Toledo Co.* (6 Cir.), 152 F. 2d 210, the Court states:

“In a judicial sale the Court is the real vendor. . . . In such a case the Court’s decree is controlling upon the parties, and their rights and obligations are fixed thereby. . . . The purchaser at a judicial sale is protected by the order or decree of the court, and he need not look beyond the decree”

In *American Dirigold Corp. v. Dirigold Metals Corp.* (6 Cir.), 125 F. 2d 446, the Court states:

“It is characteristic of a judicial sale, that the court’s decree specifically describe the property to be sold. . . . Under this rule it becomes immaterial as to what statements of exclusion, if any the receiver made at the sale.”

The Order Confirming Sale included “all inventory,” and after a hearing the Referee found that it meant all items upon the inventory shown by Receiver’s agent to Wil-Rud’s representative. [R. 86, 99, 169, 22, 31, 33.] This was binding upon the District Court. The finding that the assets were sold on an “as is” basis without warranty finds no support. No *such exclusion* was in the Order Confirming Sale. Any such statement, if made, *becomes immaterial* under the foregoing authorities. After Wil-Rud’s bid was accepted, Receiver’s attorney sought to include additional terms, which Wil-Rud’s attorney rejected. [R. 69.] The Receiver’s attorney’s attempts met no success, for the Referee in summing up his remarks

did not consider that the sale had been on an "as is" basis, and stated:

"I think practically all you have said, and as I understood it thoroughly, is that these bidders are not buying the accounts receivable and they are not taking over the cash, but that they were getting the lease in, as and when they were getting it." [R. 70.]

Even if Receiver's attorney so intended, the Order Confirming Sale did not so state, and the Referee after a hearing found against such contention. This the District Court could not disregard.

B. The doctrine of *caveat emptor* does not apply when representations are made to bidder as to quantity, and he is misled thereby to his detriment, whether such representations were fraudulently, wilfully or ignorantly made. (*Webster v. Howorth*, 8 Cal. 21, 26; 15 Cal. Jur. 307; 50 C. J. S. 648, 654.)

· The undisputed evidence discloses that the Receiver's agent gave Wil-Rud's representative an inventory [R. 86-87] and told him "naturally there would be adjustments on the merchandise that had been used in connection with the operation of business" [R. 89]; that it was impossible to discover shortages from an inspection of the plant. [R. 99.] The Referee found that Wil-Rud had relied upon the inventory and that it had a right to rely thereon, and was entitled to credit for shortages. [R. 22, 31, 33.]

C. It is also well settled that where a sale has been made under certain representations by trustee, or receiver,

the Referee is justified in allowing deductions from the purchase price for shortages and for liens or charges where the property is sold free and clear, and the rule of *caveat emptor* is not applicable.

In 6 Rem. Bkrcy. 66, ¶2572, 60, 4th Ed., the author states:

“ . . . where the sale has been made under representations by the trustee, the Court may be justified in allowing deductions from the purchase price for shortages, etc.”

(To same effect: 50 C. J. S. 626; 35 C. J. 56; *Young & McWhorter v. Smith* (W. Va.), 107 S. E. Rep. 110, 113, 114; *Gen. Electric Co. v. Interstate Electric Co.*, 201 Mo. App. 22, 209 S. W. Rep. 562; *Cypress Lumber Co. v. Tillar & Wilson*, 73 Ark. 354, 84 S. W. 490; *Hall v. McGehee* (5 Cir.), 37 F. 2d 854, 855; *Searcy v. McChord*, 1 Fed. 261.)

The evidence shows that 25,807 cases, in the possession of customers, were subject to deposits, and could not be delivered “free and clear.” [R. 143.]

In view of all the foregoing, and that negotiations were pending for several weeks between Wil-Rud and Receiver the Referee properly allowed the reductions on the purchase price by way of compromise. *Caveat emptor* did not apply.

V.

The District Court Erred in Holding That Since No One "Claimed a Lien" There Were No Liens or Charges Against the Wooden Cases. The Undisputed Evidence Shows a 60 Cent Deposit on Each Case Was Paid by Customers Which Had to Be Refunded Before Possession of the Cases Could Be Obtained. Besides, It Was Not a Proper Issue to Determine on Review.

The District Court concluded there was "no evidence that anyone had ever claimed a lien against the property purchased"; therefore there were no liens. The *undisputed* evidence shows that a 60-cent deposit had been given by customers on each case [R. 129, 133, 143], which was not indicated upon the inventory [R. 127]; that customers were entitled to this refund [R. 142-143]; that the empty cases could not be picked up from customers without refunding the 60 cents [R. 143, 144]; that such was the practice of Debtor and Receiver while operating the business [R. 143], which Wil-Rud would have to continue, if it wanted the cases [R. 144]; that on each case was a notation indicating a 60-cent deposit thereon [R. 146]; that the property was sold "free and clear" [R. 5]; that the Referee found that the cases could not be delivered "free and clear," and in his Certificate stated that it appeared customers had a lien, dependent upon possession until the refunds were paid. [R. 34.]

The *fact*, and not the *claim* of lien, determines whether one exists. Even though no customer stated, "I claim a lien on the cases," that did not disprove that one existed. The customers demanded the refund before they allowed the driver to pick up any case. [R. 142-144; 34, 23.]

This was sufficient to establish a lien, dependent upon possession.

At common law a lien consisted in the right to retain possession of the property of another until some debt or charge in connection therewith was repaid. (16 Cal. Jur. 302-3; *City of San Diego v. Higgins*, 115 Cal. 170, 178; *Quist v. Sandman*, 154 Cal. 748, 755; 53 C. J. S. 826.)

Under California statute a lien is defined as "a charge imposed in some mode other than by a transfer in trust upon specific property by which it is made security for the performance of an act." (Cal. Civ. Code, Sec. 2872; *Grey v. Horne*, 48 Cal. App. 2d 372, 375.) In connection therewith *Grey v. Horne*, *supra*, states:

" 'In its broadest sense and common acceptation, it is understood and used to denote a legal claim or charge on property, either real or personal, as security for the payment for some debt or obligation. . . . It includes every case in which personal or real property is charged with the payment of a debt.' (37 C. J. 306.)"

As stated in *Quist v. Sandman*, *supra*, the statutory lien is "but declaratory of the common-law rule and the right to a lien must be governed by the same rules which prevailed at common law. It can only be asserted under the same circumstances and conditions as it could be asserted at common law and the right to do so must be interpreted in accordance with common-law principles." (154 Cal. 748, 755.)

A lien is but an accessory to and an incident of the debt, charge or obligation for which it is security. (Cal. Civ. Code 2809.) Redemption from a lien is made by

performing, or offering to perform the act for the performance of which it is security. (Cal. Civ. Code 2905.)

Most certainly the customers had a common law, as well as statutory lien, dependent upon possession, upon the cases, until the deposits were repaid. It was not necessary to make a "claim a lien" as such, as long as they asserted the right to the refund and retained possession of the cases until the refund was paid. (*Perot's Estate v. Perot*, 148 So. 903, 177 La. 640; *Faulkner v. Harding*, 9 Mo. App. 12.)

If the transaction between Debtor and customers regarding the cases was one of bailment, the customers, as bailees, having deposited 60 cents per case, had a lien upon the cases, dependent upon possession, until the deposits were refunded. (Cal. Civ. Code 1833, providing "a depositor must indemnify the depository . . . For all expenses necessarily incurred by him . . ."; and Cal Civ. Code 1856, providing that a depository has a lien for charges, and for all moneys advanced or expended; 4 Cal. Jur. 26-27.)

The fact that the property was sold "free and clear" would not transfer the customers' liens from the cases to the proceeds. The customers were not before the Court, and the cases were in *their* possession.

As stated in *Matter of Orpheum Circuit, Inc.* (D. C., N. Y.), 20 Fed. Supp. 101:

"Since most of the assets were in the possession of an adverse claimant under claim of pledge that was more than mere colorable, the bankruptcy court had no power to sell the assets free and clear of liens."

Further the issue of the validity of the liens of the customers was not before the District Court upon review, and no determination thereof should have been made. It was sufficient to know that the Receiver would have met with serious opposition in trying to obtain possession of 25,807 cases, without repaying the 60 cent per case deposit. (*In re Riggi Bros. Co., Inc.*, 142 F. 2d 174; *Matter of the Prudence Co., Inc.*, 98 F. 2d 559; *Matter of Anderson Thorson & Co.*, 125 F. 2d 325.)

VI.

The District Court Erred in Holding That the Petition to Compromise Was a Collateral Attack Upon Order Confirming Sale. Appellant Showed Non-Compliance by Reciever With Terms of Order, Entitling It to Reduction in Purchase Price, Which Was Proper Subject of Compromise.

The Order Confirming Sale provided that Receiver sold *all inventory* together with *all other* physical assets of Debtor *wheresoever* situated, *free and clear* of any liens charges and incumbrances, and that *payment* of the purchase [R. 4-5] price was to be made *concurrently* with delivery of assets.

Appellant claimed that all the property purchased was not delivered in that there were \$18,952.16 in inventory shortages [R. 81-83], and that 25,807 wooden cases in possession of customers were not “free and clear” but subject to deposits amounting to over \$16,000. [R. 125.] The Referee, after hearing evidence, found there were

shortages and liens for which appellant would be entitled to pro-rata reduction. [R. 21-24, 31, 33, 34.]

The Court always has the right to determine if the purchaser received everything he was entitled under the decree. (*In re United Toledo Co.* (6 Cir.), 152 F. 2d 210.)

Where a sale has been made under representation of trustee of Receiver, the Court is justified in allowing deductions from the purchase price for shortages, and such has never been considered a collateral attack. (6 Rem. Bkrcty. 66.)¹¹

The Referee having determined that there were shortages and liens, that Receiver could not comply with the Order Confirming Sale, appellant was entitled to a pro rata deduction. Payment having been made *concurrent* with *delivery*, the Receiver was *not* entitled to his money until appellant's claims were adjusted. A compromise was a proper procedure. The authorities under Point I so hold. It was a speedy and expeditious procedure. Certainly it was not a collateral attack. It was common sense, and the very purpose for which the compromise statute (U. S. C. A., Title 11, Sec. 50) was enacted. To hold otherwise was error.

¹¹See page 71 of Brief where authorities are collated.

VII.

The District Court's Findings and Order, in Material Matters, Are Not Supported by the Evidence and Are Contrary Thereto, and Cover Many Matters Not Proper Issues Upon Review.

The District Court, in reviewing a Referee's order approving a compromise, is limited to *the record* before the Referee and cannot accept argument by, or statements of counsel as evidence. (*In re Paley*, 26 Fed. Supp. 952.) Evidence not taken or admitted before the Referee cannot be considered on review. (*In re Panamer Realty Corp.*, 54 Fed. Supp. 656.)

Under Specifications of Error, Nos. 4 to 7, inclusive, the District Court's Findings in certain particulars have been challenged. They are the following:

(a) That portion of Finding No. 1, reading as follows:

" . . . A bidder offered \$160,000 and thereupon a bid of \$161,000 was made on the same terms by the Wil-Rud Corporation 'for all of the outstanding shares of Yankee Doodle Root Beer Company and for the physical assets of California Associated Products . . . ' " [R. 45.]

(b) That portion of Finding No. 2, reading as follows:

" . . . That said inventory does not purport to be other than an inventory made as of July 28, 1947. That this fact was made known to all bidders. That at the time of the sale the said assets were offered 'as is' and without any warranty as to quantity or quality and without any reference to an inventory. That immediately after the confirmation of the sale, the assets so sold were delivered to the Wil-Rud Corporation. . . . " [R. 46.]

(c) Finding No. 4, reading as follows:

“4. That said sale was not made on the basis of a sale of the assets as reflected in the receiver’s inventory as of the close of business on July 28, 1947, nor was the bid of Wil-Rud so made.” [R. 47.]

(d) Finding No. 5, reading as follows:

“5. That the said Will-Rud Corporation was not warranted in relying upon nor did it rely upon the inventory in making said bid. That it was not in the best interests of creditors that the said proposed compromise be ordered.” [R. 47.]

The summary of the evidence in connection with each of the foregoing Findings, together with record references, is set forth under Specifications of Error Nos. 4-7, inclusive, and is incorporated hereunder by this reference to save space and needless repetition.¹²

These Findings in their *entirety* are based upon the *statements* and *arguments* of appellees’ counsel in the proceedings below, *and not upon any competent evidence before the Referee, or District Court*. The evidence is to the contrary. Such arguments and statements could not be accepted by the District Court as evidence.

Upon competent evidence the Referee found, that Wil-Rud’s bid was made in pursuant to and in reliance upon an inventory admittedly shown its agent by Receiver representative, who stated that adjustments for assets used would be made [R. 86, 87, 89, 107, 21, 22, 31-33]; that the inventory shortage was \$18,952.16 [R. 81-83]; that

¹²See brief pages 39 and 40 for summary of evidence for Finding No. 1; pages 40 to 42 for Finding No. 2; pages 42 and 43 for Finding No. 4; pages 43 to 46 for Finding No. 5.

there were 60 cents per case deposits upon 25,807 wooden cases, amounting to over \$16,000 [R. 125, 142, 143], which appeared to be a lien thereon [R. 22, 34]. The objecting creditors never offered any evidence to the contrary, or otherwise. At the hearing on November 7, 1947, Receiver's counsel strenuously *argued* that the assets had been sold "as is" but the record belied that contention and the Referee found to the contrary [R. 21, 23, 31, 33.] After Wil-Rud's bid at the sale had been accepted, Receiver's counsel attempted to inject such condition, which was rejected [R. 68-69]. The Referee then stated to Receiver's counsel, "I think practically all you have said, and as I understood it thoroughly, is that these bidders are not buying the accounts receivable and they are not taking over the cash but that they were getting the lease in, as and when they were getting it" [R. 70]. Counsel's argument is *not evidence*; if the statements at the sale contradicted the testimony adduced at this hearing (and it does not), the Referee's finding adverse to Receiver is binding. The "as is" theory again was invoked *by way of argument* [R. 165] at the compromise hearing, but no evidence in support thereof was offered. There is no evidence that Wil-Rud's bid was not based upon the inventory, or that it did not have a right to rely thereon. The evidence is to the contrary. Findings which purport to determine the merits of controversies existing between the Receiver and Wil-Rud were not proper issues to determine upon Review. The District Court's Findings and Order are contrary to, and not supported by, the evidence.

Conclusion.

We respectfully submit that the record is replete with prejudicial, reversible error, which materially affect Appellant to its prejudice. We therefore respectfully submit that the Order of the District Court be reversed with directions to affirm the Referee's Order approving the compromise, together with appellant's costs of appeal.

Respectfully submitted,

CHARLES J. KATZ,

Counsel for Appellant.

SAMUEL W. BLUM,

Of Counsel.

No. 12309

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WIL-RUD CORPORATION,

Appellant,

vs.

E. A. LYNCH, Receiver and Trustee of the Estate of California Associated Products Co., AARON LEVINSON, VICTOR KRAMER, BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, F. W. BOLTZ CORP., and LEO BRILL,

Appellees.

BRIEF OF E. A. LYNCH, RECEIVER.

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THOMAS S. TOBIN,

Of Counsel.

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PAUL P. O'BRIEN,

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Appellees.

BRIEF OF E. A. LYNCH, RECEIVER.

The controversy before this Court involves the disposition of a petition for leave to compromise a dispute ensuing between the appellant and the Receiver after a judicial sale to the appellant of assets belonging to the bankrupt estate of the California Associated Products Co., which sale was duly confirmed by the Court and the order of confirmation has long since become final [Tr. pp. 12-16; order confirming sale, Tr. pp. 3-7]. The Court is not concerned with the proceedings brought to enforce compliance with this sale, namely, the petition for order to show cause re Wil-Rud Corporation which is found on pages 8 and 9 of the Transcript. No order was ever made on that order to show cause.

Briefly, the history of the controversy is as follows: The proceeding originated in the District Court under Chapter XI of the National Bankruptcy Act on July 29, 1947, and under this Chapter XI proceeding E. A. Lynch was appointed Receiver. The Chapter XI proceedings did not succeed and bankruptcy ultimately resulted on April 26, 1948. Mr. Lynch came into possession of the assets of the bankrupt located at No. 3631 Union Pacific Avenue, Los Angeles, in a plant known as the Yankee Doodle Root Beer Company in the latter part of August. The bankrupt was engaged in this plant in the manufacture and distribution of root beer. An offer was made through Aaron Levinson, a creditor, and a member of the informal Creditors' Committee [Tr. p. 51] to purchase the assets of the Yankee Doodle plant for \$135,000.00 at private sale and without competitive bidding [Tr. pp. 29 and 30]. The Court declined to approve this proposal and ordered the property sold at competitive bidding [Tr. p. 30]. The matter came on for hearing before the Referee on October 15, 1947 [Tr. p. 50] and the offer of \$135,000.00 was renewed in open Court by Mr. Levinson [Tr. p. 52]. The offer was made on behalf of one Miller and proposed to buy all of the outstanding shares of the Yankee Doodle Root Beer Company, the "physical" assets of the California Associated Products, all trade names, trade-marks, all formulas, and registered trade styles, the lessee's interest in the lease, and expressly excluded merchandise held by the Bank of America as a pledge, and certain items held at Fresno to secure two pledges of firms located there. The offer also excluded cash on hand, accounts or notes receivable, or deposits made by those corporations. No reference was made to inventory. The purchaser proposed to take over the existing insur-

ance on a pro rata basis, title to be delivered to him free and clear except the water softener. A check for \$10,000.00 was tendered [Tr. pp. 52 and 53]. The Referee announced that he was going to sell the assets to the highest bidder for the greatest amount of money [Tr. p. 54].

Mr. Katz submitted the second bid in open Court amounting to \$137,500.00 [Tr. p. 59]. The bidding went up, Mr. Miller raising it to \$140,000.00 [Tr. pp. 59 and 60]. It continued upward, and at page 62 of the transcript Mr. Katz made the statement "Mr. Rudolph bids \$146,000.00 on the same basis as the Miller bid excepting only that with respect to the lease he will take whatever right, title, and interest in the estate that the estate can convey to him." After a short recess [Tr. p. 65] the bidding resumed again [Tr. p. 68] and climbed to \$161,000.00. The Referee thereupon announced that the assets were sold to the Wil-Rud Corporation for \$161,000.00.

Immediately after this announcement, Mr. Gendel, attorney for the Receiver, proceeded to clarify any question as to what was being sold, and the Referee then reiterated his verbal confirmation of the sale with this statement [Tr. p. 71]:

"This meeting is adjourned. The sale is confirmed for \$161,000.00 to Samuel C. Rudolph & Associates, Incorporated, a corporation."

There was no mention of inventory adjustments at any time in the proceedings or during the conduct of the sale.

That the sale was made "as is," appears to be perfectly clear from that part of the statement of Mr. Gendel be-

ginning at the bottom of page 68 of the transcript and continuing on to page 69. Mr. Gendel said:

“The Receiver is selling machinery, equipment and fixtures located at the place of business of the California Associated Products Co., 3631 Union Pacific Avenue, and the inventory *as is now*, subject only to the balance owing on the water softener of \$1699.17.”

Further significance of this statement appears in the order confirming the sale [Tr. pp. 4 and 5]. The order confirming the sale confirms the sale to the buyer of all machinery, fixtures, equipment, all inventory, all lessee's improvements, all furnishings, all supplies and unfinished products of every class, character and description whatsoever, located at 3631 Union Pacific Avenue, Los Angeles, California, together with all the other physical assets of the debtor corporation *wheresoever situated*, and together with all of the physical assets of every class and character of the Yankee Doodle Root Beer Co., a corporation, as of October 15, 1947, at 5:00 o'clock P. M. The day and hour October 15, 1947, at 5:00 o'clock P. M. is again referred to by Mr. Gendel at transcript pages 74 and 75. It is clearly apparent that the assets taken over by the appellant were the assets of the bankrupt as they existed on October 15, 1947 at 5:00 o'clock P. M. (All italicized matter ours.)

Seven days thereafter, on October 22, 1947, the Referee signed an order confirming and approving the sale, which order was approved by Mr. Katz and Mr. Blum, counsel for appellant. The ten days to review this order of confirmation expired at the latest on November 2, 1947 (Bankruptcy Act, Sec. 39-c). The appellant went into possession of the plant of the bankrupt, taking it over on October 15 at 5:00 P. M., the date of the sale in open

Court [Tr. p. 151]. Appellant had been operating the plant for three months when the controversy that is before this Court came before the Referee [Tr. p. 156, testimony of Wolf Wilder].

It developed after appellant had taken over the plant that there were alleged to be outstanding some 25,000 beverage cases with bottles which were in the hands of storekeepers and retailers of Yankee Doodle Root Beer. On each of these cases of bottles the purchaser had made a bottle charge of 60¢ as indemnity for their return [testimony of Ralph J. Yates, Tr. p. 129]. This charge of 60¢ per case was added to the invoice on which the shipments of root beer were made [Tr. p. 130]. There was no written statement anywhere to the effect that the distributor had a lien on the case or the bottles in the case [Tr. p. 130]. So far as Mr. Yates knew, no claims had ever been filed in the Bankruptcy Court for any of the 60¢ per case deposits by any of the distributors [Tr. p. 131].

When a customer placed an order for additional root beer, the delivery was made by the driver, the bottle charge of 60¢ per case was charged to the customer, and upon the driver bringing back the empty case and bottles to the plant, the customer's account was credited with 60¢ per case [Tr. p. 142]. Mr. Yates testified [Tr. p. 144] that on practically every sale the Receiver made there was a return of empties and a credit per case of 60¢ was made to the customers. On page 145 of the transcript he testified that he knew of no instance where the sum of 60¢ was paid in cash without receipt of an order for new merchandise, and characterized the transaction as being "like exchanging milk bottles." When the customer would put a bottle out, the Receiver would put another

bottle in. The life of these cases and bottles was about twelve times a round trip owing to the customers retaining bottles or cases, the storekeeper being unable to return them to the Receiver or the bankrupt, and the result would be no claim for refund [Tr. p. 145].

After running this business for approximately two weeks, Wil-Rud Corporation, the appellant, declined to pay the last \$61,000.00 of its purchase price. On October 31, 1947, the Receiver instituted a summary proceeding before the Referee to compel the appellant to comply with his contract. An order to show cause was issued on October 31, 1947. No answer appears to have been filed hereto, no affirmative defense to the order to show cause was asserted, and no steps were taken by the appellant to rescind the sale which had been confirmed by written order of the Court nine days before. Wil-Rud, the appellant, was still well within the time to take a review of the order of confirmation under Section 39-c of the National Bankruptcy Act or to obtain an extension of time to file such petition for review under the same section which provides that a person aggrieved by an order of a Referee may, within ten days after the entry thereof, or within such extended time as the Court may for cause shown allow, file with the Referee a petition for review. Furthermore, if the appellant felt that it was defrauded or overreached, it could very easily have served a notice of rescission and asked the Court to vacate its order of confirmation. It did none of these things.

The hearing on the order to show cause came on before Referee Dickson on November 7, 1940. Appellant then

contended that it bought the assets free and clear of encumbrances, that there was a shortage of \$18,952.16, and then later raised the contention that 25,000 cases of empty bottles were out in the hands of customers and that it should not be required to pay the purchase price which it had agreed upon and which the Court had confirmed. The matter was partially heard [Tr. pp. 72-113, incl.] and the Referee indicated from the bench that he was going to allow a set-off of \$18,000.00 [Tr. pp. 110 and 112]. Mr. Katz was to prepare the order covering the proceedings up to this point.

Before this order was prepared, the appellant approached the Receiver with an offer to compromise the matter. The Receiver thereupon caused a petition to be prepared to compromise the matter [Tr. pp. 12-16]. The Referee sent notice to creditors of the proposed compromise, calling a meeting to pass thereon (Bankruptcy Act, Secs. 58-a-3 and 6). The meeting was held on January 29, 1948, four months after appellant had gone into possession of the bankrupt's plant and long after the order of confirmation had become final [Tr. p. 16]. At this hearing a number of creditors appeared either in person or by counsel, namely, Aaron Levinson, F. W. Boltz, Victor Kramer and the Bank of America [Tr. p. 115]. Testimony was taken and objections to confirmation of this compromise were entered in the record by Mr. Levinson on his own behalf as a creditor and on behalf of his client, W. M. Yaffee & Co. The Bank of America, through Mr. Steinmeyer, likewise voted against

confirmation [Tr. p. 165], and Victor Kramer and F. W. Boltz Corporation registered their objections thereto at page 166 of the transcript. The District Court has found that these creditors represented over one-half of the unsecured claims [see Memorandum Opinion of Judge Ben Harrison, Tr. p. 37, the District Judge's Findings of Fact No. 3, Tr. p. 46].

The Referee overruled the expressed disapproval of this majority of creditors and with the exception of one creditor present at the meeting, namely, Yankee Doodle Root Beer Bottling Co. of San Fernando Valley, Inc., which expressed no opinion [Tr. p. 166], no creditor expressed approval of the order confirming this compromise. A petition for review of the Referee's order was taken by Aaron Levinson, Bank of America National Trust & Savings Association, Leo Brill, F. W. Boltz Corp. and Victor Kramer [Tr. p. 25]. The Referee certified the matter to the District Court [Tr. pp. 29-36] and the matter was heard. The appellant here, which was not a formal party to the record before the Referee and was in nowise concerned with the litigation save as it might redound to its benefit, was permitted to file a brief before the District Court on review [Tr. p. 44]. District Judge Ben Harrison reversed the order of the Referee, filing a well written Memorandum Opinion in connection therewith on December 16, 1948 [Tr. p. 37] and thereafter making formal written findings of fact, conclusions of law and order granting petition for review, and reversing the order of Referee approving compromise [Tr. p. 44].

et seq.] The Wil-Rud Corporation on June 20, 1949, filed its notice of appeal to this Court.

The Minute Order of Judge Harrison, reversing the Referee, was filed December 16, 1948. Notice of appeal was not filed and served for more than *six months* thereafter [Tr. p. 49]. Judge Harrison's formal findings of fact and conclusions of law were not signed until May 24, 1949.

We believe that this delay would in any event be fatal to appellant's attempted appeal even assuming, but not conceding, that appellant here was a proper party to appeal from an order which involved only the Receiver and protesting creditors.

Mutual Building & Loan Association v. King (C. C. A. Ninth Cir.), 83 F. 2d 798;

In re Interstate Oil Corporation, 63 F. 2d 674.

The Receiver, not feeling aggrieved by the District Court's order of reversal which meant \$18,500.00 more to the bankrupt estate, did not take an appeal therefrom. The only person challenging the correctness of Judge Harrison's order here is the purchaser. It is attempting to chisel down its purchase price months after the sale to it had been confirmed and become final.

ARGUMENT, POINTS AND AUTHORITIES.

The Receiver submits that this appeal should be dismissed and the judgment of the District Court affirmed for the following reasons:

1. That the appeal was taken too late.
2. That Wil-Rud Corporation was not a party to the litigation before the Referee or the District Court, and is not a proper party appellant here.
3. That the remedy of the appellant was by rescission and not refusal to pay the purchase price.

We shall discuss these three points separately.

The Appeal Has Been Taken Too Late.

The Minute Order of Judge Harrison was signed and filed on December 16, 1948. It incorporated therein a memorandum opinion, the concluding paragraph of which reads as follows:

“In view of the fact that the petition to compromise, filed after the confirmation of the sale was a collateral attack on the sale, and considering the consequences of such action if permitted, the order of the Referee in approving the compromise is hereby reversed.

“Dated: This 16th day of December, 1948.

BEN HARRISON, Judge.”

The appeal in this case was filed on June 24, 1949, six months and five days after Judge Harrison's Minute Order. The fact that a formal order was later written up, signed and filed, did not stop the time to appeal running.

In *Mutual Building & Loan Association v. King*, 83 F. 2d 798, this Court had before it a similar problem. On

a contested adjudication, trial of which was had before a Special Master, exceptions were filed to the Master's Findings. United States District Judge Harry Holzer entered a Minute Order overruling the exceptions to the Master's report, approving the report and dismissing the involuntary petitions and intervening involuntary petitions on file. This Minute Order was made on October 25, 1934. Thereafter, on December 24, 1934, a formal judgment was signed and filed. On January 23, 1935, some of the petitioning creditors petitioned for rehearing. On March 22, 1935, the Court ordered stricken, attempted petitions in intervention filed by other creditors. An appeal was taken to this Court by the petitioning creditors and the question raised as to whether or not the appeal was taken too late. Apparently, at the time of the argument the appellee conceded orally that the Minute Order of October 25, 1934, was not an appealable order because the parties thereafter agreed to a form of dismissal which was approved, signed and filed by the trial judge on December 24, 1934. Additional briefs were filed subsequent to the argument, and appellee in those briefs apparently changed his position and contended that the Minute Order of October 25, 1934, was a final order refusing to adjudicate the appellee a bankrupt, was appealable as such, and that the time for appeal could not be extended by the subsequent entry of the formal order to the same effect. Regarding this contention, Judge Wilbur said:

“Both these propositions are thoroughly established.”

After quoting the Minute Order, the Court went on to say:

“This is an order refusing an adjudication of bankruptcy (In re Interstate Oil Corporation (C. C.

A.), 63 F. (2d) 674; Hudspeth v. Woods (C. C. A.), 70 F. (2d) 504; Stevens v. Nave-McCord Merc. Co. (C. C. A.), 150 F. 71; In re Bieler (C. C. A.), 295 F. 78), and is appealable under 11 U. S. C. A. §48. The right to appeal could not be revived by subsequent entry of the same order. Hudspeth v. Woods, *supra*, Bonner v. Pottef (C. C. A.), 47 F. (2d) 852. It follows that the denial of the adjudication of bankruptcy had become final before any of the proceedings of which the appellant complains. The appeals were allowed both by this court and the District Court, and therefore are properly before us. The appeals from the order of December 24, 1934, however, are ineffectual for any purpose because the adjudication had become final before that order was entered.”

In re Interstate Oil Corporation, 63 F. 2d 674, cited by this Court in the preceding case, the Court said:

“The order of October 5, 1931, was not a judgment refusing to adjudge the defendant a bankrupt from which an appeal may be taken under 11 U. S. C. A. §48(a)(1); considered as an order granting leave to amend the petition by adding a statement of the facts showing insolvency, the appeal could be allowed by this court only (11 U. S. C. A. §47(b)), and in either event the appeal would have to be taken within 30 days of the order (11 U. S. C. A. §§47(c), 48). The appeal from the order of October 5, 1931, is therefore dismissed.”

We submit that under Section 25-a of the National Bankruptcy Act the appeal had to be taken within thirty days after written notice to the aggrieved party of the entry of the order, judgment or decree complained of, proof of which notice shall be filed within five days after

service or, if such notice be not served and filed, then within forty days from such entry. There is nothing in the record to indicate notice in writing, so the maximum period in which to take an appeal was forty days. However, the appeal was not taken until six months and five days after the Minute Order, and we submit that the appeal should be dismissed.

The Appellant Wil-Rud Corporation Is Not a Proper Party Appellant Here and Should Not Be Recognized as Such by This Court.

In the Court below, Wil-Rud made an offer to the Receiver to compromise the dispute between it and the Receiver, which had reached an acute stage and had resulted in an order to show cause against Wil-Rud why it should not pay the balance of the purchase price forthwith. Whether this offer of compromise was made in writing or was verbal does not appear in the record. At least it is in nowise incorporated into the pleadings. Indeed, it would appear from the Receiver's petition for leave to compromise [allegation No. 3, Tr. p. 13] that the compromise was oral in nature. We quote:

‘That after a full and complete interchange of facts, your petitioner and his counsel have conferred with the purchaser and its counsel in an effort to determine whether or not a compromise and settlement could be reached so that the administration of the within estate could be brought to a termination; that after negotiations and conferences, the following compromise and settlement has been offered by the purchaser, and is now being recommended to this Court by your petitioner as apparently being for the best interests of the within estate, subject to the approval of this Court.’

This petition to compromise which was dated December 26, 1947, was signed by E. A. Lynch, as Receiver, and by Gendel & Chichester, the Receiver's attorneys. It was approved by Charles J. Katz, attorney for Wil-Rud, and was verified by Mr. Lynch. Submission of this compromise was not made by the appellant here but was made by the Receiver. At the hearing thereon on January 29, 1948, the objecting creditors appeared in person and by their respective counsel pursuant to the notice of hearing thereon (Bankruptcy Act, Sec. 58-a-6). They were unquestionably parties to the record as creditors and had an unqualified right to be heard. Otherwise, the provision under Section 58 for notice to creditors would be nothing but a mockery if notice to creditors were to be sent and still creditors have no standing to be heard. On the other hand, Wil-Rud's rights extended only to submitting its offer to the Receiver and having the Receiver submit the same to the Court on due notice to creditors and to have the same considered by the Court and creditors. This was done and the Court and the protesting creditors found themselves at loggerheads. The creditors whose money was being compromised did not like the compromise and expressed themselves in no uncertain terms. The Referee on the other hand, felt that the compromise should be confirmed, and over the protests of these five objecting creditors, confirmed the proposed compromise. The creditors as parties in interest thereupon took a review with the Receiver as respondent on review and not Wil-Rud. The District Court, considering the fact that Wil-Rud had obtained this plant, had operated it for several months and had not sought to rescind its purchase, but had sought to chisel the Receiver down on the purchase price, reversed the order of the Referee.

Wil-Rud has now taken an appeal joining the Receiver as a party appellee.

In the *Matter of Inter-City Trust Company*, alleged bankrupt, 295 Fed. 495, the Court of Appeals for the First Circuit, in holding that a petition to revise was brought too late, being six months after the order complained of, said:

“Etherington filed on February 26, 1923, a motion to dismiss on the ground that the Inter-City Trust Company was not within the scope of the Bankruptcy Act. This pleading was, on the motion of the petitioning creditors, struck from the record. Etherington is a stranger to these proceedings. His rights, if any, cannot be brought before this court by other creditors.”

In the *Matter of Rose*, 86 F. 2d 69, the bankrupt sought to appeal from an order affecting the Conciliation Commissioner under a Section 75 case. The Court said:

“The conciliation commissioner thereafter on September 30, 1935, filed his petition in the court below, praying that appellee bank and all of its officers and agents be restrained from proceeding with the action to quiet title, and that the receiver appointed by the state court be enjoined from interfering with the property. Appellant did not join in the petition. To this petition appellee bank, its attorneys, and the receiver appointed by the state court filed a demurrer, which on December 13, 1935, was sustained without leave to amend, on the ground that the act as amended on August 28, 1935, was unconstitutional and void.

“This appeal was taken by the bankrupt, the conciliation commissioner not being a party to the appeal. * * *

“Appellees contend that appellant has no standing before this court, because she was not a party to the petition in the trial court, but cites no authorities therefor. *Amicus curiae* contends that appellant ‘was not only a party to record but she was obviously the real party in interest in the court below and is still the real party in interest in the present appeal.’ * * *

“The filing of the petition by appellant was the equivalent of an adjudication in bankruptcy. *Wilkinson v. Cooch* (C. C. A. 9th Cir.), 29 Am. B. R. (N. S.) 384, 78 F. (2d) 311, 312.

“*Amicus curiae* apparently contends that, because appellant filed the petition, she was a party to all collateral proceedings which might arise in the main proceeding. If that is the contention, it is untenable, because many issues arise in the administration of a bankrupt’s estate, in which the bankrupt cannot even remotely be interested, for example, controversies between the trustee and the creditors.

“We are not here deciding whether or not appellant was ‘the real party in interest’ so that she could file a petition like the one before us. The question before us is whether the bankrupt had a right to appeal from the order denying the petition filed by the conciliation commissioner.

“The rule in the federal courts is that a person cannot appeal from an order, decree, or judgment who is not a party or privy to the record. *U. S. ex rel. State of Louisiana v. Jack*, 244 U. S. 397, 402, 37 S. Ct. 605, 61 L. Ed. 1222; *Grant v. United States*, 227 U. S. 74, 33 S. Ct. 190, 57 L. Ed. 423; *Ex parte Leaf Tobacco Board of Trade*, 222 U. S.

578, 32 S. Ct. 833, 56 L. Ed. 323; *Guion v. Liv. Lond. & Globe Ins. Co.*, 109 U. S. 173, 3 S. Ct. 108, 27 L. Ed. 895; *In re Cockcroft*, 104 U. S. 578; *Bayard v. Lombard*, 50 U. S. (9 How.) 530, 559. One exception to the rule is that, where a person had been treated as a party in the trial court, he may be allowed to appeal." Citing cases. The cases cited by *amicus curiae*, *Andrews v. Thum* (C. C. A. 5th Cir.), 64 Fed. 149, and *Hinckley v. Gilman C. & S. R. Co.*, 94 U. S. (4 Otto) 467, 24 L. Ed. 166, fall within this exception.

"Obviously appellant was not a party to the proceeding. She was not named as a party petitioner, and was not ordered to show cause. She sought no relief, although the relief sought by a third person would have enured to her benefit. No relief was sought against her.

"Likewise she could not be a privy, for she does not claim any right to an injunction as successor to the rights of the conciliation commissioner. * * *

"Whatever rights were given by the act to the conciliation commissioner were not also given to appellant, and therefore, if the conciliation commissioner had any right to an injunction, appellant did not own that right with him, and did not succeed to it. Thus she is not in privity with him."

The appeal was dismissed.

In the *Matter of Peppers Fruit Co.*, 24 Fed. Supp. 119, the Referee made an order authorizing the Trustee to compromise two suits against officers of the bankrupt which were pending. Creditors holding 169 claims to-

taling \$264,873.66 approved the compromise. C. J. Lehman, a creditor with a small claim of \$55.00, opposed it. Thereafter, two other creditors who apparently had not appeared at the hearing, joined with Lehman in filing a petition for review. The Trustee moved to dismiss the petition. The District Court said:

“However, the contention of the trustee that Carpenter Hiatt Sales Company and E. D. Nickerson are not proper parties to the review does appear to be well founded. The Circuit Court of Appeals for the Ninth Circuit, in the case of *In re Rose* (1936), 32 Am. B. R. (N. S.) 404, 86 F. (2d) 69, held that, under federal practice, no person may appeal from an order, decree, or judgment who is not a party or privy to the record. The court there decided that the bankrupt, in a section 75 proceeding, was not a proper party applicant, since she was not a party to the hearing in the court below. To the same effect see *In re Inter-City Trust* C. C. A. 1st Cir. 1924), 3 Am. B. R. (N. S.) 566, 295 F. 495. The contrary view seems to be held by the Sixth Circuit in *Forsher v. Graham*, 14 Am. B. R. (N. S.) 29, 32 F. (2d) 654. This court feels that, in the interest of economy and efficiency of administration of bankrupt estates, reviews from referee’s orders, at least those orders which are made after notice, should be limited to applications by parties who have appeared at the hearing before the referee and participated therein. Any other holding would leave the door open to a flood of reviews which would result not only in delay and expense, but would place an almost intolerable burden upon the district judges. This contention of the trustee is, therefore, sustained and the review is dismissed as to Carpenter Hiatt Sales Company and E. D. Nickerson. This leaves C. J. Lehman as the sole reviewing creditor.”

The Appellant, if Dissatisfied With His Bargain, or if Any Fraud or Mistake Was Involved Therein, Had a Clear Remedy by Rescinding His Contract Promptly Upon Discovery, Returning What He Had Bought to the Trustee Who Succeeded the Receiver Instead of Contumaciously Refusing to Pay the Purchase Price but Retaining the Fruits of the Transaction.

One of the grounds relied on by the District Court in reversing the order of the Referee confirming this compromise was the defiant attempt on the part of appellant to refuse to pay the purchase price stipulated, and yet at the same time retain the fruits of his bargain. Even assuming that appellant did not know within ten days after the confirmation of the sale that a shortage existed in bottles and cases, upon discovery of this alleged shortage it still had its remedy. The transaction took place in the State of California. Section 1691 of the Civil Code of California provides as follows:

“Rescission, when not effected by consent, can be accomplished only by the use, on the part of the party rescinding, of reasonable diligence to comply with the following rules:

“1. He must rescind promptly, upon discovering the facts which entitle him to rescind, if he is free from duress, menace, undue influence, or disability, and is aware of his right to rescind; and,

“2. He must restore to the other party everything of value which he has received from him under the contract; or must offer to restore the same, upon condition that such party shall do likewise, unless the latter is unable or positively refuses to do so.”

In the case at bar, appellant bid the assets of this going business in at a judicial sale held before the Referee

on Wednesday, October 15, 1947 [Tr. pp. 50, 71]. The written order confirming the sale was signed seven days later, October 22, 1947, and covered the physical assets of every class and character of the Yankee Doodle Root Beer Company as of October 15, 1947 [Tr. p. 5]. It is evident from the discussion at page 70 of the transcript that possession was given the night of October 15, the date of the sale. The second highest bid at its judicial sale was made by Mr. Miller in the amount of \$160,000.00 and was raised by appellant to \$161,000.00 [Tr. p. 68]. If appellant claimed that it was entitled to the cases and bottles which were out of the possession of the bankrupt corporation, which were not in the possession of the Receiver and never had been, and on which credit would be given, when returned in connection with future orders of this going business which appellant purchased, and the Receiver was either unable to deliver or had misrepresented to appellant, appellant's remedy was by prompt rescission. A receiver or trustee in bankruptcy is not so sacrosanct that if he is guilty of overreaching a purchaser at a judicial sale, the purchaser has no right of rescission. Indeed, it has been held that notwithstanding the Trustee's title to property in the possession of the bankrupt as a junior lienholder thereof, or as an execution creditor with his execution returned wholly unsatisfied under Section 70-a of the National Bankruptcy Act, a seller who has been defrauded by the bankrupt may assert his right of rescission against the Trustee.

In *Jones v. Hobbie Grocery Co.*, 246 Fed. 431 (U. S. Court of Appeals, Fifth Circuit) in a case where a bankrupt a few days prior to filing his voluntary petition in bankruptcy purchased merchandise from the appellee knowing of his insolvency and with no reasonable

expectation of being able to pay for it, held that the defrauded vendor was entitled to reclamation. In that case the Referee apparently granted the petition in reclamation which was affirmed by the District Court. On appeal by the Trustee, in affirming the lower Court, the Court of Appeals said:

“If * * * the sale was induced by false or fraudulent representations as to his financial condition on which the seller relied, or would not have been made but for his fraudulent concealment of his financial condition or of the fact that he did not intend to pay or reasonably expect to be able to pay for the goods, the seller has the right to rescind the sale and recover his property. *Maxwell v. Brown Shoe Co.*, 114 Ala. 304; *Donaldson v. Farwell*, 93 U. S. 631.

“The seller’s petition in the pending case, and the evidence adduced in support of it, we think sufficiently show that, as against the purchaser, he had the right, under the rule just stated, to rescind the sale and recover the goods sold. It is contended in behalf of the appellant that this right does not exist against him, the purchaser’s trustee in bankruptcy. This contention is sought to be supported by invoking the provision of the Bankruptcy Act that ‘such trustees, as to all property in the custody or coming into the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies and power of a creditor holding a lien by legal or equitable proceedings thereon.’ Bankruptcy Act §47a(2), as amended by Act of June 25, 1910.

“The contention stated cannot prevail unless under the Alabama law the right conferred on the purchaser’s creditor by the acquisition of a lien on the latter’s property by legal or equitable proceedings is

superior to that of the defrauded seller to rescind the sale and reclaim the goods sold. In our opinion that superiority does not exist under the Alabama law.

“The judgment is affirmed.”

Bearing in mind that this sale took place in California, we refer the Court to *Russell v. Penniston*, 55 Cal. App. 492, at page 495, where the Court said:

“Neither was the plaintiff entitled to a judgment of rescission because he was in default at the time he claimed he attempted to rescind. (Fairchild etc. Co. v. Southern etc. Co., 158 Cal. 264, 273 (110 Pac. 951.) Furthermore, he was not entitled to rescind except that he complied with the provisions of section 1691 of the Civil Code, and the findings are to the effect that he did not do so.”

We submit that under the Fourth Circuit decision just cited, if a trustee were subject to rescission by reason of the fraud of his predecessor, the bankrupt, how much more so would the Receiver be, both under California law and under the Bankruptcy Act, to rescind in the event he had deceived or misled the purchaser at a judicial sale conducted by him. If, as contended here by appellant, it bid on this going business in competition with other prospective purchasers in the sum of \$161,000.00 under the mistaken belief induced either by the silence or affirmative fraud of the Receiver that it would receive 25,000 cases of empty bottles which were scattered all over Los Angeles and vicinity in the possession of customers, then his remedy was to promptly rescind, petition the Court for vacation of the order of confirmation, restore or offer to restore to the Receiver the going business which he had purchased and receive back from the Receiver and the Court the purchase price which he had theretofore paid.

The record in this case can be searched from beginning to end, and nowhere will there be found any offer on the part of appellant to turn back its going business to the Court and take its money back. On the contrary, it sought to have its cake and eat it by coming in and whining to the Receiver, the Referee and the creditors several weeks after the confirmation of the sale, that it understood that among the assets it was acquiring were these widely scattered cases which would come back into its possession upon sale of new cases of filled bottles, and that it was now entitled to a substantial reduction of the \$161,000.00 purchase price which it had agreed to pay. It cannot be said that this appellant went out from the Court secure in the belief that it was getting these scattered bottles and cases in its purchase. That such was not the case is clearly evident from the statement made by Mr. Gendel, the then attorney for the Receiver, commencing at page 68 of the transcript, while Mr. Katz, attorney for the purchaser was present and participated in the colloquy. At page 68 of the transcript, after the Referee had announced "sold for \$161,000.00 to the Wil-Rud Corporation, Mr. Gendel, in order that there could be no misunderstanding, made this statement at pages 68 and 69 of the transcript:

"May I on behalf of the Receiver make a closing statement in connection with what I understand the Receiver wants to confirm as part of the sale so that there is no question.

"The Receiver is selling to the buyer all of his right, title, and interest in and to the lease of the premises in question occupied by the debtor corporation. * * * The Receiver is selling the machinery, *equipment*, and fixtures located at the place of business of the California Associated Products

Co., 3631 *Union Pacific Avenue*, and the inventory as is now subject only to the balance owing on the water softener of \$1699.17.” (Italics ours.)

At the bottom of page 69, Mr. Katz, attorney for the appellant, participated in this discussion. Manifestly, the equipment located at the place of business of California Associated Products Co., 3631 Union Pacific Avenue, could not and did not include the widely scattered cases of empty bottles in the hands of customers unless all of those customers were located at No. 3631 Union Pacific Avenue, and we do not think that any such contention will be made. If it were intended that these cases and bottles were to be included in the purchase, then was the time for Mr. Rudolph to have spoken up on behalf of the successful bidder, and, in the event of misunderstanding as to the location of the equipment, withdrawn his bid of \$161,000.00 or had the matter clarified, and in any event, the Receiver could then have fallen back on the pre-existing \$160,000.00 bid made by Mr. Miller. The bankrupt estate would have suffered only to the extent of \$1,000.00 at the most and everyone would have been happy. As it was, the competing bidders were allowed to disperse, the \$160,000.00 bid was lost, appellant took over the business and later sought to improve its position by refusing to pay the balance of the purchase price. This it cannot do.

In the *Matter of Union Co-op. Bakery*, 4 F. 2d 435, a purchaser of real property from a Receiver for the sum of \$10,000.00 which was confirmed, sought to vacate the sale. His petition was denied. The purchaser in that case had bought the property on September 17. He made no objection after confirmation thereof until November 1st. The order refusing to permit him to withdraw was affirmed.

In *Hall v. McGehee*, 37 F. 2d 854, the trustee negotiated a private sale of a business he had been operating and out of which some of the merchandise had been sold. The purchaser submitted a bid wherein he agreed to pay sixty cents on the dollar for the merchandise, office and warehouse furniture and fixtures, and the automobile equipment on the basis of the appraised value covering items as shown on the inventory. He knew at the time he submitted his bid that some of the inventoried goods had been sold and that there would be a joint check of the inventory between the purchaser and the Trustee. The check revealed a shortage of \$2,677.43 which was accepted by the Referee. The purchaser tendered a check to the Trustee which was in an inadequate amount to cover the balance, disputing the inventory checked figures. The Referee made an order requiring the purchaser to pay the full amount claimed by the Trustee. That order was reversed by the District Court and on appeal the Court of Appeals for the Fifth Circuit said:

“If the appellee was dissatisfied with his purchase because of the shortage, he could have asked the court not to confirm the sale, and to rescind the transaction. On the contrary, he sought its confirmation and paid part of the purchase money, with knowledge of the shortage, after it had been confirmed. Under these circumstances, the utmost he could have asked in equity would have been a proportionate abatement of the purchase money, and this the referee gave him, based on his own estimate of the amount of goods that were short. (Citing cases.)

“Appellee knew he was buying at a judicial sale, at which the rule of *caveat emptor* applied. In *re The Monty Allegre*, 9 Wheat. 616, 6 L. Ed. 174; *Carney v. Averill*, 110 Me. 172, 85 A. 494; *John Schaap Drug Co. v. Rone* (C. C. A.), 19 F. (2d) 517. He

also had actual knowledge that a part of the merchandise had been sold after it had been inventoried, and agreed with the trustee upon a joint check for that reason. Even if the trustee failed to deliver the amount inventoried, the appellee, having knowingly bid for and received the unsold part of the merchandise, and having asked a confirmation of the sale on this partial basis, cannot assert that the contract of sale was broken thereby. The transaction would constitute a sale of only what was left of the stock. The appellee himself testified, 'We bought what was down there,' and the trustee was due to deliver no more.

"The conclusion reached requires the reversal of the order of the District Court and the remand of the case for further proceedings in conformity with the order of the referee; and it is so ordered."

In the case at bar, much the same situation existed. In the petition for order to show cause against Wil-Rud Corporation [Tr. p. 8] the Receiver sets up as of October 31, 1947, that the appellant had paid the sum of \$100,000.00 on the purchase price. In his petition to compromise the controversy, appearing at page 14 of the transcript, is the figure of a credit for \$125,000.00 in favor of appellant. In the interim between October 31, 1947, and the date of the petition to compromise, December 26, 1947, this appellant had paid the Receiver an additional \$25,000.00 of the purchase price with full knowledge of the facts as they existed.

It is also highly significant that in the case at bar, Sam Rudolph, who did the bidding for appellant at its sale, when put on the stand by Mr. Katz, at page 169 of the transcript at no time testified that he had bought this going business in reliance on an inventory taken several

months before. He simply testified that he had examined page 88-a of the inventory and that the Receiver had not made delivery to him of the items listed on page 88a. He did not say "I relied on the inventory taken several months before; I bought on that inventory" but merely testified that he had examined it.

On the contrary, Rudolph's testimony on behalf of appellant is replete with statements which indicate that he was not relying on the inventory nor that any agreement existed for rectifying shortages which would naturally occur in this going operating business. We quote some of these statements made by Mr. Rudolph:

"We took for granted an inventory taken by the Receiver or Trustee is always correct and we have bought goods for the last twenty-five or thirty years and we don't do a lot of checking when we go in and look at an inventory because we know when they check an inventory it is correct. They do make allowances when they are short or over. The reason we didn't pay the balance of the \$161,000.00, we wanted to check and see if they were going to make good. We checked it once and they were dissatisfied and we had another man go over and make the second check." [Testimony of Sam Rudolph, p. 100.]

"Q. What is it you say Mr. Yates told you about the shortages? A. Mr. Yates did not say anything about shortages. He said, 'You understand that they sold the Monterey grape juice.' In going through the plant there was a lot of cases of grape juice.

Q. I just asked what he said to you. A. I am telling you.

Q. About the subject matter of shortages. A. The only thing he told me was sold at that time was the Monterey grape juice.

Q. That is all Mr. Yates told you? A. Yes.”
[Tr. p. 102.]

“Q. What did Mr. Yates say with reference to the subject matter of making good? A. I never said anything about him making good at all. I didn’t make any such statement about him making good. We were just checking the inventory at the time.

Q. I see. A. Don’t misunderstand. He didn’t say he would make anything good.

Q. He didn’t say the Receiver would make anything good, did he? A. He said, ‘We were going to check it.’

Q. All he said, ‘We are going to check out the inventory,’ is that it? A. That is correct.” [Tr. p. 103.]

In the *Matter of Solantkias*, 33 F. 2d 200, the Court said at page 201:

“We concur in the views expressed by the referee that Diamond had no right to withhold the payment of the \$3,500.00 on account of alleged discrepancies between the inventory and the goods actually turned over by the receiver to Diamond. This was a judicial sale to which the rule of *caveat emptor* clearly applied. If a fraud be practiced upon the purchaser at a public sale, he should immediately ask to have the sale set aside and return the property. The court could then give him the relief to which he is entitled. He could not adjust that matter himself by withholding a part of the purchase money.”

Conclusion.

It is clearly evident that this appellant is only seeking here to attenuaté a purchase price at a judicial sale in a deal which it may have found unprofitable. What has become of the assets which this appellant obtained from the Receiver on his bid of \$161,000.00, we do not know. We do know, however, that it has not returned them to the Receiver nor has it offered to do so. Were such the case, appellant would have some equitable standing before this Court. Instead, it ignored the petition for review taken by protesting creditors as petitioners on review and the Receiver as respondent and now seeks to inject itself before this Court as an appellant from the reversal of an order which affected the Receiver or creditors only. This it cannot do.

See: *In re Bender Body Company*, 139 F. 2d 128.

At the time this petition to compromise was submitted by the Receiver and recommended, the Receiver and his then counsel believed in good faith that a compromise was better than a lawsuit. However, at the hearing in confirmation of the compromise, there was most decided objection on the part of the majority of creditors in amount, and of all the creditors present and voting save one who was more or less noncommittal [Tr. pp. 165-166].

Notwithstanding the vigorous objection of these large creditors, the Referee overruled their protests, and convinced that this compromise was not to the best interests of this estate, and their money being involved, these credi-

tors went to the expense of procuring a transcript and taking the matter up on review. The District Judge, after analyzing the matter, wrote his opinion reversing the Referee's order. The District Judge, in writing this opinion, was apparently very strongly impressed with this appellant's effort to retain the advantages of his bargain, together with the refund sought through the compromise [Tr. p. 43] and the fact that appellant made no effort to rescind and return the property [Tr. p. 40]. The appellant has never offered to restore the consideration to the estate, and we respectfully submit that the judgment of the District Court should be affirmed.

Dated: March 30, 1950.

CRAIG, WELLER & LAUGHARN,
By THOMAS S. TOBIN,
Attorneys for Appellee E. A. Lynch.

THOMAS S. TOBIN,
Of Counsel.

No. 12309

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WIL-RUD CORPORATION,

Appellant,

vs.

E. A. LYNCH, Receiver and Trustee of the Estate of California Associated Products Co., AARON LEVINSON, VICTOR KRAMER, BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, F. W. BOLTZ CORP., and LEO BRILL,

Appellees.

RESPONDENT CREDITORS' REPLY BRIEF.

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Appellees.

RESPONDENT CREDITORS' REPLY BRIEF.

Statement of Facts.

On October 22, 1948, certain assets of California Associated Products Co., the bankrupt, were sold at public auction to appellant. The order confirming the sale, which was approved by counsel for the appellant, reads in pertinent part as follows:

Now, Therefore, the undersigned Referee does hereby approve and confirm the sale by E. A. Lynch, as Receiver in the within estate, of certain personal property, hereinafter described, to Wil-Rud Corporation, a corporation, for a cash consideration to be paid to said E. A. Lynch, as Receiver, in the sum of

\$161,000.00, delivery of the assets to be made upon the signing of the within order, and payment therefor to be made concurrently with delivery to the buyer.

1. The Receiver, by this order, is deemed to have sold, and does sell to the buyer, all machinery, fixtures, equipment, all inventory, all lessee's improvements, all furnishings, all supplies, and all finished and unfinished products of every class and character and description whatsoever located at 3631 Union Pacific Avenue, Los Angeles, California, together with all the other *physical* assets of the debtor corporation, wheresoever situated, and together with all of the physical assets of every class and character of the Yankee Doodle Root Beer Company, a corporation, *as of October 15, 1947, at 5:00 o'clock P. M.*; all of said items are sold free and clear of any liens, charges, and encumbrances, save and except a balance owing on a sales contract to the Los Angeles Water Softener Company in the sum of \$1,699.17, which balance the purchaser assumes and agrees to pay [Tr. p. 5]. (Emphasis ours.)

Because only \$100,000.00 of the purchase price had been paid, the Referee issued an order directing appellant to show cause why it should not pay the \$61,000.00 balance due [Tr. p. 10]. At the hearing on the order to show cause, appellant claimed it had no objection to the order confirming the sale [Tr. p. 77], but questioned "the meaning" of the order. At this hearing appellant contended that it did not receive the quantities it purchased,

and that the extensions of prices on an inventory sheet were incorrect [Tr. p. 80]. Appellant's counsel stated that there was nothing in the transcript of the proceedings at the sale on October 15, 1948, which "did not indicate the *ordinary* adjustment between purchaser and seller in this kind of a transaction would not take place, something which takes place every day when shortages develop." [Tr. pp. 111 and 112.] (Emphasis ours.)

The Referee indicated his agreement with this position of the appellant and directed counsel for appellant to prepare an appropriate order [Tr. p. 112]. It was then disclosed that appellant was asserting a claim for empty bottles and cases allegedly purchased but not received [Tr. p. 112]. The Referee directed counsel for the Receiver and appellant to "get together" on a stipulation of facts regarding the alleged shortages of empty bottles and cases [Tr. p. 113].

Instead of preparing the order and stipulation of facts as directed by the Referee, appellant paid \$25,000.00 more on the purchase price and made an offer to Receiver to compromise its alleged claims against the Receiver in return for a reduction in the bid price from \$161,000.00 to \$142,500.00 [Tr. p. 14].

At the subsequent hearing on the Receiver's petition for leave to compromise [Tr. p. 20] these respondent creditors appeared and opposed the proposed compromise [Tr. p. 164 *et seq.*]. Despite the fact that every creditor present at the hearing opposed the compromise (except one, who was non-committal), the Referee verbally ap-

proved the compromise [Tr. p. 167], and then permitted appellant, over the protest of one of the respondents, to offer evidence [Tr. p. 168]. An order was then entered approving the compromise [Tr. p. 20]. Respondent creditors petitioned for a review of that order and the District Court rendered a memorandum opinion, followed by a minute order, in which it reversed the Referee's order [Tr. p. 37].

The appellant here was not a party of record to the proceedings before the District Court. Without leave of any Court, it filed a notice of appeal, and named as appellees all those who were parties to the record in the Courts below.

No order has ever been entered on the order requiring appellant to show cause why the balance of the purchase price should not be paid. Appellant has complied to the extent of paying \$25,000.00 of the \$61,000.00 due when the order was issued. Appellant also stated on January 29, 1948, it would pay \$17,500.00 more that day but has never done so [Tr. p. 122]. That proceeding is not now before this Court. The only questions now before this Court are whether appellant has any standing to prosecute this appeal and whether, if appellant has such standing, the District Court was correct in concluding that the petition to compromise should not have been granted.

Summary of Argument.

I. The appeal should be dismissed because the time for appeal expired before appellant filed his notice of appeal.

II. Appellant has no standing to appeal because it was not and could not have been a party to the proceedings before the Referee on the Receiver's petition to compromise; and because appellant was not aggrieved by the District Court's order denying the petition to compromise.

III. The appeal should be dismissed because it constitutes a collateral attack upon the order confirming the sale to appellant.

IV. The District Court was correct in its conclusion that the petition to compromise should be denied.

(a) The District Court was not bound by the findings and conclusions of the Referee because there was no conflict in the evidence presented.

(b) Since the sale was not made according to any inventory, there could be no inventory shortage to provide a basis for a compromise; the rule of *caveat emptor* applies.

(c) The Referee had the power to sell free from liens, so that there was no ground for any compromise based upon the alleged existence of liens.

ARGUMENT.

I.

The Appeal Should Be Dismissed Because the Time for Appeal Expired Before Appellant Filed Notice of Appeal.

These respondents adopt the argument on this point set out in the brief of respondent E. A. Lynch, Receiver, at pages 10 to 13.

II.

Appellant Has No Standing to Appeal Because It Was Not and Could Not Have Been a Party to the Proceedings Before the Referee on the Receiver's Petition to Compromise; and Because Appellant Was Not Aggrieved by the District Court's Order Denying the Petition to Compromise.

Appellant's rights as a purchaser of the property of the bankrupt estate were prescribed by the order confirming the sale, which was approved by the appellant's counsel before it was entered [Tr. p. 7]. It is to be noted that appellant has never sought to review this order, nor has it ever, by any means, sought to rescind the sale. Rather, appellant chose to attempt to obtain a reduction in the price it had bound itself to pay by making an offer of compromise to the Receiver. The Receiver had no power or authority to bind the bankrupt estate to accept the compromise offer. He could only present it to the Court for approval or rejection. The Bankruptcy Court, and it alone, had the power to change the rights and liabilities of the purchaser which had become fixed when the original order confirming the sale became final. These rights and liabilities could only be changed by an order of the Bankruptcy Court duly entered and allowed to become final.

In this case, appellant's rights and liabilities with respect to the property were never changed after the sale was confirmed because the Referee's order approving the compromise never became final. It follows that appellant was not injured by the District Court's order disapproving the compromise because that order did not adversely affect any vested right of appellant. Since appellant was not injured or aggrieved, it has no standing to appeal.

Appellant had no subsisting right to have its compromise offer accepted. All the Receiver could have promised appellant was that he would submit the proposed compromise to the Court. By a denial of the petition to compromise appellant did not lose a subsisting right; nor have any of its rights been invaded. Appellant has never had the right to compel the Receiver to perform the terms of the offer to compromise. If the Referee had never made any order with respect to the compromise offer, appellant could not have complained. The District Court's order appealed from, in effect, left appellant in the same position as if no order approving the compromise had ever been entered. The denial of the petition to compromise did not deprive appellant of the two remedies it had for alleged shortages: the right to appeal from the order confirming sale and the right to rescind. If it has now lost either or both of these rights it is entirely appellant's fault.

Counsel in his notice of appeal says appellant is a party aggrieved by the order of the District Court denying the petition to compromise. But is appellant aggrieved? Did appellant lose a "right" to buy the property for \$142,500.00? Obviously not, since no final judgment vesting in appellant the right to buy the property for the reduced price was ever entered. Appellant never had such a right. Appellant has been, and still is, in the position of

an onlooker awaiting the acceptance by a principal (the Court) of an offer made through an agent (the Receiver). No Court has entered a final order giving its approval to the proposed compromise. Appellant, therefore, has no standing to appeal.

It is further to be noted that it cannot be demonstrated with any certainty that the denial of the petition to compromise resulted in any injury to appellant, financial or otherwise. Indeed, appellant's counsel stated that "we are not anxious to get the compromise, *candidly*, because the cases do us more good than the amount we are settling for." [Tr. p. 154.] (Emphasis ours.)

In the case of *In re Michigan-Ohio Bldg. Corp.*, 117 F. 2d 191, 194 (1941) (7 Cir.), the Court approved the trustee's account but retained jurisdiction for two years. The appellants who originally were bondholders of the debtor became stockholders under the reorganization plan. They appealed from that portion of the order of the Court which provided for retention of jurisdiction by the Court on the ground that the Court was without authority to reserve power. The Court *sua sponte* raised the question as to whether the appellants had such an interest or were to such a degree aggrieved as to create in them the right to appeal. The Court held no one may appeal from a judgment unless he has an interest therein direct, immediate, pecuniary and substantial. Furthermore, that the right invaded or the injury sustained must be subsisting and immediate, and not one arising as some possible, remote unforeseen consequence.

III.

The Appeal Should Be Dismissed Because it Constitutes a Collateral Attack Upon the Order Confirming the Sale to Appellant.

At the hearing on the order to show cause why it should not pay the \$61,000.00 balance, appellant's counsel stated appellant had no objection to the order confirming the sale [Tr. p. 77]. Therefore, there was no basis for an appeal from that order. The only alternative left to appellant was to attempt to rescind the sale. It made no attempt to do this but instead withheld \$61,000.00 of the purchase price until the order to show cause was issued. Then appellant proposed a compromise of its claim for shortages and paid \$25,000.00 of the \$61,000.00 balance owing. It thereby sought to keep the benefits of the sale instead of rescinding and returning the assets; and to get a reduction of the purchase price by offering a compromise to the Receiver.

In *Slocum v. Edwards*, 168 F. 2d 627 (1948) (2nd Cir.), a sale was held of the bankrupt's interest in a trust. All parties including the Referee believed that the subject matter of the sale was the right of the trustee to attach the bankrupt's income from the trust. Long after the sale took place, the bankrupt became entitled to a one-twelfth interest in the trust by reason of the death of another. The bankrupt's estate was reopened and the trustee petitioned the Court for an order setting aside the confirmation of the sale of the interest in the trust. The Referee granted the petition, the District Court reversed, and then the Circuit Court reinstated the order of the Referee.

At page 631 of the opinion of the Circuit Court, there appears the following:

“As pointed out by Professor Moore, 4 Collier on Bankruptcy (14th Ed. 1942), 1587, 1588, ‘The validity of the sale is not open to inquiry or impeachment in any collateral proceeding in either a state or federal court,’ and further, ‘Collateral attack must be distinguished from a petition or motion to set aside a sale, filed in the bankruptcy proceedings.’ On the findings below there is no ground of action against individuals; thus there is no showing of fraud, but only of mutual mistake. Hence the direct correction of the order of confirmation is both the proper and the only appropriate remedy.”

As stated in 6 *Remington* at p. 85, Sec. 2584, sales in bankruptcy may not be attacked collaterally. The proper method is by review in the Bankruptcy Court.

IV.

The District Court Was Correct in Its Conclusion That the Petition to Compromise Should Be Denied.

(a) The District Court Was Not Bound by the Findings and Conclusions of the Referee Because There Was No Conflict in the Evidence Presented.

Appellant argues at length that it was error for the District Court to reverse the Referee's order approving the compromise in the absence of a clear abuse of discretion by the Referee (App. Br. p. 51 *et seq.*). In this argument counsel overlooks the fact that there was no dispute before the Referee regarding what occurred at and before the sale; and that there was no question regarding the credibility of witnesses. The question before the District Court was solely one of determining and applying the proper legal principles to the uncontroverted facts. In such a situation, the rule is that the District Court is not bound to give any special sanctity to the findings and conclusions of the Referee. Where, as here, the facts are not controverted, the District Court is in just as good a position as the Referee to draw the proper factual inferences from the undisputed testimony, the record and the documents. The District Judge is in a better position to select and apply the proper rules of law to these factual inferences and to reach a correct decision than is the Referee.

Carr v. Southern Pacific Co., 128 F. 2d 764, 768 (C. C. A. 9, 1942);

Katcher v. Wood, 109 F. 2d 751 (C. C. A. 8, 1940);

Stewart v. Ganey, 116 F. 2d 1010, 1013 (C. C. A. 5, 1941).

(b) Since the Sale Was Not Made According to Any Inventory, There Could Be No Inventory Shortage to Provide a Basis for a Compromise; the Rule of Caveat Emptor Applies.

Appellant contends first that there existed certain inventory shortages which made it only right, proper and imperative that the purchase price be reduced. This contention, we submit, is completely answered by an examination of the order confirming the sale, set forth verbatim in the Statement of Facts.

Where a sale is based upon an inventory, the assets sold should, of course, be checked against the inventory when delivery is made. Here the order confirming the sale contemplated delivery of the assets upon the signing of the order confirming the sale (Oct. 22) but fixed the assets sold as of an earlier date, to wit, 5:00 P. M. October 15, 1947. In other words, the time fixed for delivery of the assets was not the same time as that used to determine the assets sold. This demonstrates that the sale was not based upon an inventory.

There is no reference anywhere in this order to the so-called *July 28* inventory. It was clearly a sale on an "as is, where is" basis as of October 15, 1947, the date of the sale. The plain meaning of the words "all inventory" in the order was all goods, wares, and merchandise in existence as of the date of sale. Counsel's statement (App. Br. p. 69) that the Referee found that the words "all inventory" meant all items on the July 28 inventory is without support in the record. The Referee made no such finding.

The entire record supports respondents' position as to the meaning of these words. The appellant was advised by the Receiver's attorney in open court on October 15,

1947, a week before the order confirming the sale was signed, that the sale was of “inventory *as is now*” [Tr. p. 69].

The bid had no reference to any inventory, but rather was “for the physical assets” of the bankrupt [Tr. pp. 52, 59, 69]. The appellant was told by the Receiver’s agent at the time a copy of the July inventory was furnished that the Receiver had not taken a physical inventory, that the Receiver and the debtor had been operating the business for approximately two months, and that some of the merchandise had been used [Tr. p. 89]. Appellant’s own testimony was to the effect that Receiver made no undertakings either before or after the sale to make good or adjust for shortages [Tr. pp. 102-103]. It is significant that the July inventory, which was shown to appellant about ten days before the bidding, was not made by the Receiver and that appellant was advised of this fact [Tr. pp. 85 and 89].

Appellant’s principal managing officers and its counsel have both had enough experience with bankruptcy sales to estop them from any plea of ignorance that the rule of *caveat emptor* applies in such sales [Tr. pp. 92, 100].

A second complete answer to appellant’s contention that it is entitled to an adjustment of the purchase price is that the rule of *caveat emptor* applies to bankruptcy sales. Professor Collier states the rule as follows:

The rights and *quantum* of property acquired by the purchaser depend primarily upon the terms of the sale as ordered or agreed upon. In the absence of

specific warranty clauses the bankruptcy sale is governed by the rule "*caveat emptor*." It is for the purchaser to examine in time what is sold and under what conditions. He may not after discovery of a defect covered by the "*caveat emptor*" principle refuse payment of the purchase price or claim abatement. (4 Collier, Bankruptcy, 14th Ed. p. 1588.)

The learned District Judge in deciding this case cited and relied upon this quotation and upon the following authorities:

John Schaap & Sons Drug Co. v. Rone, 19 F. 2d 517 (C. C. A. 8, 1927);

Hall v. McGehee, 37 F. 2d 854 (C. C. A. 5, 1930);

Handlan v. Bennett, 51 F. 2d 21 (C. C. A. 4, 1931).

Even where an inventory was submitted to the bidders at public sale it has been held the purchaser is not permitted to withhold a portion of the purchase price on the ground of alleged inventory shortages. *In re Solantkias*, 33 F. 2d 200 (D. C. Pa., 1929). The case is so close on its facts to the instant case that we think it pertinent to quote from the opinion (p. 201):

We concur in the views expressed by the referee that Diamond had no right to withhold the payment of the \$3,500 on account of alleged discrepancies between the inventory and the goods actually turned over by the receiver to Diamond. This was a judicial sale to which the rule of *caveat emptor* clearly applied. If a fraud be practiced upon the purchaser at a public sale, *he should immediately ask to have the sale set aside and return the property*. The court

could then give him the relief to which he is entitled. He could not adjust that matter himself by withholding a part of the purchase money.

The reason for the application of the rule of *caveat emptor* to bankruptcy and judicial sales is that sound public policy dictates the necessity that such sales have a high degree of stability and finality. To apply any other rule is to throw open the door to the practice of purchase price "chiseling" and to invite endless litigation at the expense of creditors. There is no sound reason, nor have we found any precedent for the application of a rule of "equitable adjustment" for which appellant contends. It is submitted that the adoption of such a rule would substantially impair the administration of bankrupt estates. Realizing this, the Courts have uniformly said: "Let the buyer beware!"

It is submitted that since the sale was on an as is, where is basis, the existence of shortages from an inventory made 2½ months before sale by neither the Receiver, the Court nor the purchaser, cannot provide a sound basis for a compromise reduction of the appellant's bid price.

(c) The Referee Had the Power to Sell Free From Liens, so That There Was No Ground for Any Compromise Based Upon the Alleged Existence of Liens.

Appellant contends (App. Br. p. 72 *et seq.*) that the compromise should have been approved because the existence of alleged liens on bottles and cases made it impossible for the Trustee to deliver the property "free and clear of liens."

The transactions between the bankrupt and the holders of the empty cases were nothing more than contracts of "sale and return."

See:

Goebel Brewing Co. v. Brown, 306 Mich. 222, 226,
10 N. W. 2d 835 (1943);

In re Allen, 183 Fed. 172 (E. D. Ark. 1910);

Cf. Buck v. Commissioner, 83 F. 2d 627 (C. C. A.
9, 1936).

Even if we assume for the purpose of the argument that the empty wooden cases and bottles were subject to a lien, the Referee had the power to sell them free from liens, and they were so sold [Tr. p. 5].

6 *Remington on Bankruptcy* 71, Sec. 2577;

Arizona Power Co. v. Smith, 119 F. 2d 888, 890
(1941) (Cir. 9, 1941);

Van Huffel v. Harkelrode, 284 U. S. 225, 227, 52
S. Ct. 115.

The consent of the lienholder (if a lien existed) was not necessary nor was it necessary for the Referee to determine the validity of the alleged lien.

6 *Remington on Bankruptcy*, 77 and 78, Secs. 2578
and 2579.

In any event the alleged lien holder is not before this Court asserting a lien or complaining of the order of the Court confirming the sale.

Conclusion.

The decision of the District Court should be affirmed because:

1. The appeal was taken too late.
2. The appellant was not aggrieved by the order appealed from.
- 3 This appeal is an attempt to attack collaterally a previously entered appealable order which has become final.
4. On the merits, the District Court was correct in its conclusion that the appellant's offer in compromise should be rejected.

Respectfully submitted,

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No. 12309

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of

CALIFORNIA ASSOCIATED PRODUCTS Co., a corporation,
doing business as YANKEE DOODLE ROOT BEER BOT-
TLING COMPANY,

Bankrupt.

WIL-RUD CORPORATION,

Appellant,

vs.

E. A. LYNCH, *et al.*,

Appellees.

APPELLANT'S REPLY BRIEF.

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FILED

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MAY 23 1950

PAUL P. O'BRIEN,
CLERK

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Appellees.

APPELLANT'S REPLY BRIEF.

Preliminary Statement.

Two briefs have been filed by appellees—one by the Receiver—the other by certain Creditors. In reply, appellant will treat both briefs together, except where separate replies are deemed necessary.

We submit, that appellees have been unable, and noticeably have failed, to answer or refute appellant's contentions, arguments and authorities presented in the opening brief.¹

¹O. B. will refer to Appellant's Opening Brief; R. B. will refer to Receiver's Brief; C. B. will refer to Creditors' Brief. Appellee, E. A. Lynch, will be referred to as Receiver and Appellee Creditors will be referred to as Creditors.

We find no reply to appellant's contention that it was error for the District Court to determine on the merits the controversies between Receiver and appellant. There is no denial that approval of a compromise by the Referee is discretionary, yet appellees have shown no abuse of discretion by the Referee, without which it was error for the District Court to reverse the Referee. The District Judge's findings have not been sustained by competent evidence; they are sought to be supported by counsel's arguments, not evidence. Appellees' own arguments and authorities affirmatively establish that the 25,807 wooden cases involved were not sold "free and clear of any liens, charges and incumbrances." Under appellees' contention Receiver had no title or interest in the cases to sell, and sold only a *burden or charge imposed thereon, i. e.*, the right to repurchase said cases, when and as required by customers, by repaying to them the 60 cents per case deposit, previously deposited with Debtor and Receiver. Certainly this did not constitute a sale of the cases "free and clear" nor compliance with the provisions of the Order Confirming Sale in respect thereto. Appellees make no reference to, or comments upon the representations admittedly made by Receiver prior to the sale, nor to the provisions of the Order Confirming Sale by which delivery and payment are made concurrent conditions. They have confused the issue regarding Receiver's failure to comply with the Order Confirming Sale with claims of "collateral attack" and "*caveat emptor.*" These and other matters will receive further comment herein.

We also deem it appropriate to make certain observations concerning Receiver's brief. It indeed presents a strange anomaly. On the one hand we have a Receiver who prepared and filed a petition to compromise controversies, alleging under oath that such compromise is for the best interests of the estate; who appeared before the Referee and sought the approval thereof, presenting evi-

dence in support of the compromise; who prepared findings and an Order approving the same; and who appeared before the District Judge seeking to uphold and support the Referee's order. On the other hand we have this same Receiver appearing before this Honorable Court, and taking a position diametrically opposed to that urged by him in the Court below; who now strenuously opposes the compromise, and challenges appellant's position herein; who joins his late adversaries and blatantly cries that appellant is "chiselling" when he well knows that appellant is entitled to certain equities and performance by Receiver of the Order Confirming Sale. Such Dr. Jekell and Mr. Hyde tactics are without parallel in judicial history or procedure. If Receiver did not desire the compromise, as an officer of the Court he should not have misled appellant and the Referee in seeking its approval. He was made an appellee because we believe he is a necessary party to the appeal. This does not give him the right to reverse the position taken by him in the Court below. So zealous and adversary has the Receiver become that he seeks a dismissal of the appeal, relying upon authorities held no longer applicable by this Court, and fails to cite a case, wherein one of counsel for Receiver participated, decided by this Court and directly opposed to the contention now urged by Receiver.

Comment on Appellees' Statement of Facts.

We respectfully submit that the true facts are presented in Appellant's Opening Brief, supported by record references, which, we urge, should be accepted by the Honorable Court. No attempt will be made to repeat the same, except where clarity demands. Appellees make much ado about the words "as of October 15, 1947, at 5:00 o'clock p. m." contained in the Order Confirming Sale. This, they argue, shows that the sale was on an "as is, where is" basis. Such contention finds no support in the record.

Those words were included to provide the "cut off date" when Receiver's liability for losses, or his right to profits, if any, should cease; the record conclusively shows this. *After* the sale was completed, the following proceedings were had:

"Mr. Lynch: The bidder will take this business over *as of what date*; and will continue to operate, and what will happen to the profits, if any, that are derived from the operation of this business?"

Mr. Gendel: Mr. Katz, do you want it *tonight*?

Mr. Katz: I think we want to get the order."
[R. 70; see also R. 93, 105, 106.]

The foregoing conclusively indicated that Receiver was concerned about profits or losses occurring between the sale and confirmation; hence, the "cut off date" was agreed upon. The "tonight" referred to meant 5:00 o'clock p. m., October 15, 1947, the date of sale.

The Receiver, mindful of the rule that loss occurring between the sale and its confirmation cannot be visited upon the purchaser (*In re Fink*, (6 Cir.) 224 Fed. 92, 93; *Hartford Accident and Indemnity Co. v. Crow*, (6 Cir.) 83 F. 2d 386, 387; 6 Rem. Bkptcy. 41, Sec. 2558), sought protection against loss occurring between October 15, 1947 (date of sale), and the confirmation. The date "as of October 15, 1947, 5:00 o'clock p. m." was agreed upon and inserted in the Order as the "cut off date" with respect to liability for losses and profits, if any, arising from the operation of the business—not with respect to quantitative count. Certainly the Referee so understood the term [R. 93]. Appellees rely strongly upon the attempt by Receiver's attorney to include the "as is" condition *after* the sale was completed and appellant's bid was accepted. This attempted change was rejected by the Referee, who replied to Receiver's counsel as follows:

"The Referee: I think practically all you have said, and as I understood it thoroughly, is that these

bidders are not buying the accounts receivable and they are not taking over the cash, but that they were getting the lease in, as and when they were getting it." [R. 70.]

In judicial sales the Court (Referee), and not the Receiver, is the *real vendor*. (*In re United Toledo Co.*, (6 Cir.) 152 F. 2d 210; O. B. 69.) Therefore the Referee's remarks, and not those of Receiver's counsel, become material. Besides, the attempted exclusion made by the Receiver's counsel after the sale was completed, and not included in the Order, becomes immaterial. (*American Dirigold Corp. v. Dirigold Metals Corp.*, (6 Cir.) 125 F. 2d 446; O. B. 69.)

At the hearing of November 7, 1947, counsel for Receiver conceded that it was *after* the bidding was completed, that he first attempted to include the "as is" condition [R. 76]. The Order Confirming Sale contained no such provision—on the contrary it included among the assets sold "all inventory" [R. 4]. Furthermore, Receiver's counsel conceded that auction sales made in Court were usually made pursuant to inventory [R. 73]. If the *sale* was made "as is" without any reference to inventory, why did the Receiver *check out the merchandise against the original inventory as it was delivered or offered to appellant?* [R. 85-89.] *Such check was made not once, but twice. Why?* [R. 98-100.] *Why did the Receiver prepare a document entitled "Inventory Shortages at California Associated Products Company, Inc." [R. 81-83] which actually disclosed the differences in the items reflected upon the inventory and those delivered to appellant?* [R. 89; O. B. 25.] Would this have been done, or even be necessary if the sale had been made "as is"? Most certainly not. These questions remain unanswered in appellees' briefs. The actions of the Receiver belie his present contentions and conclusively establishes that the

sale was made *pursuant to inventory*, and not "as is." The Referee had the right to consider the acts and conduct of the Receiver in determining the meaning of the Order Confirming Sale.

Actual possession of the assets was not given to appellant until *after* confirmation of sale [R. 46]; not before, as Receiver states. Appellees also contend that appellant's (Rudolph's) testimony was to the effect that the Receiver made no undertakings to make good or adjust shortages (R. B. 27; C. B. 13). The portions of testimony quoted do not correctly reflect this testimony; omitted portions give it a different meaning. Yates, Receiver's agent, testified as follows:

"A. I told Mr. Rudolph that we had not taken a physical inventory, that Mr. Lynch had been operating the business and the Debtor had been operating the business since July 28, *and naturally there would be adjustments on the merchandise that had been used in connection with the operation of the business.*" (Italics ours.) [R. 89.]

Sam Rudolph, following a portion quoted in Receiver's brief, further testified:

"Q. Who checked the second time? A. It was checked by the Receiver's man twice. They thought there was something wrong and they rechecked it again. Not only that, *but they pointed out it was short and they would make it good.*

Q. Who said that? A. Mr. Yates." (Italics ours.) [R. 100.]

The weight to be accorded this testimony and whether any discrepancy or conflict existed therein was solely the province of the Referee. The District Judge, on Review, could neither weight the testimony, nor resolve any conflicts therein. (See authorities O. B. 65-66; also *In re Cummings*, 84 Fed. Supp. 65, 67; *Grace Bros. v. C. I. R.*, (9 Cir.) 173 F. 2d 170-73.) Besides it was conceded that

auction sales in Court usually were made pursuant to inventory [R. 73] and that allowances were always made for shortages [R. 100]. The Referee undoubtedly was familiar with such practices.

Appellees state that since no formal order was ever signed after the November 7, 1947, hearing, that all matters in regard thereto become immaterial. That no formal order was signed is attributable solely to pending negotiations culminating in the compromise. The proceedings had and the Referee's decision at such hearing were referred to and made a part of the petition to compromise [R. 12-13]; and presented, argued and considered at the compromise hearing. They were included and made a part of the record upon Review and upon this appeal. Such proceedings were properly considered. (*In re Kansas Journal Post Co.*, 144 F. 2d 816.)

Appellees' Brief Ignores the Rule That Approval of a Compromise Is Discretionary—the Decision Upon the Merits of the Controversies Not Being Involved—That Upon Review the Sole Question Is Whether the Referee Has Abused His Discretion, and the District Judge Cannot Determine the Controversies Upon the Merits.

In our Opening Brief we have established the foregoing rules. We have shown that it was error for the District Judge to determine upon the merits of the controversies between receiver and appellant—the subject of the compromise—*upon review from the Referee's Order Approving the Compromise*. Appellees have submitted *no authorities*, which permits a determination upon the merits, either by the Referee, or by the District Judge upon review. Yet they seek to argue the merits of said controversies as though that were the real issue involved. In our reply we adhere to our position taken in the Opening Brief that the controversies cannot be determined upon the merits, upon review, but will demonstrate that even if such issues were involved that the District Judge erred in his determinations, Findings and Order.

ARGUMENT—POINTS AND AUTHORITIES.

I.

The Appeal Was Timely Taken and Cannot Be Dismissed Because (A) the Time for Appeal Commences From the Notice of Entry of the Formal Order or Entry, if No Notice Is Given; and (B) if the Time Commences From the Minute Order, Appellant Also Has Appealed From the Minute Order of December 16, 1948, Within Thirty Days Thereof, and That Appeal Is Pending.

- A. The Time for Appeal Runs From Notice of Entry or if Notice Be Not Given, From the Entry of the Formal Order, and Not From the Minute Order.

The formal order of the District Court Granting the Petition for Review and Reversing Order of Referee, was entered and docketed May 26, 1949 [R. 48]. Notice of appeal therefrom was filed June 21, 1949 [R. 49], and within thirty days of the entry. This appeal therefore was timely. (U. S. C. A., Title 11, Sec. 48, subd. (a); Bkptcy. Act, Sec. 25a, quoted in O. B. 6.) Appellees' contention that time for appeal commences with entry of the minute order is no longer open to question. A formal order is now required in the District Court and the time for appeal commences either from notice of entry of such order, or actual entry, if notice be not given.

General Order 37 (11 U. S. C. A. fol. Sec. 53) makes the Federal Rules of Civil Procedure applicable to Bankruptcy proceedings. Rule 52a of the Federal Rules of Civil Procedure provides that "in all actions tried upon the facts without a jury, the Court shall find the facts specially and state separately the conclusions of law thereon, and direct the entry of the appropriate judgment." Rule 58 thereof provides "When the Court directs entry of a judgment . . . the Clerk shall enter judgment

forthwith . . .” Rule 54a thereof provides that the term “judgment” as used in said rules “include . . . any order from which an appeal lies.” Rule 79a thereof provides “that the Clerk shall keep a book known as ‘civil docket,’ and shall enter therein each civil action to which these rules are made applicable.” Under the foregoing rules, in determining the Review from the Referee’s order approving the compromise it was necessary for the District Judge to make formal findings of fact and state separately his conclusions of law thereon, and to make and direct the entry of a formal order. This order was not entered and docketed until May 26, 1949. Within thirty days thereafter this appeal was filed. It was and is timely taken.

In *Rosenberg v. Heffron*, 131 F. 2d 80, 82, this Honorable Court decided that the Federal Rules of Civil Procedure are applicable to Bankruptcy proceedings; that the time for appeal commenced to run from the notice of entry of the *formal order*, or the entry thereof if no notice is given, *and not from the minute order*. This case is decisive against appellees’ contention that the appeal was taken too late. (See also *In re D’Arcy*, 142 F. 2d 313; 8 Rem. Bkptcy. 1950, Supp. 42, Secs. 3775 and 3775.01.)

Neither the minute order, nor the opinion of the Judge, even if couched in mandatory form, constitutes an entry of judgment sufficient to start the time for appeal. (*Rosenberg v. Heffron*, *supra*; *In re D’Arcy*, *supra*; 8 Rem. Bkptcy. 1950 Supp. 42, Secs. 3775 and 3775.01.) An opinion does not constitute a judgment. (*Cory v. Hamilton Nat. Bank*, 31 F. 2d 379, 380.) Where both an informal order and a subsequent formal order covering the same matters had been made, the time for appeal runs from the entry of the formal order. (*Cory v. Hamilton Nat. Bank*, *supra*; *In re Federal Coal Co.*, 31 F. 2d 375; *Oliver v. Garlick*, 2 F. 2d 132.) The minute order of

December 16, 1948, on its face shows it is but an informal order referring to the memorandum of opinion directed to be filed [R. 36, 37]. This opinion, of course, is not a judgment. Further the record fails to disclose the entry of said minute order [R. 37].

Appellees' authorities, *Mutual Building and Loan Ass'n v. King*, 83 F. 2d 798, and *In re Interstate Oil Co.*, 63 F. 2d 674, were decided *prior* to the adoption of the Federal Rules of Civil Procedure *and are no longer applicable*. This Court so expressly held in *Rosenberg v. Heffron*:

"Our decision in *Mutual Building & Loan Ass'n v. King*, 9 Cir., 83 F. 2d 798, cited by appellees, was prior to the adoption of the Federal Rules of Civil Procedure."

B. Appellant Also Has Appealed From the December 16, 1948, Minute Order Within Thirty Days Thereof, and Such Appeal Is Now Pending.

The *certified* record on appeal discloses the following:

(a) That on January 14, 1949, appellant filed a Notice of Appeal from the minute order of December 16, 1948 [Cert. Tr. on App. 50].

(b) That on January 14, 1949, appellant filed a Bond for Costs on Appeal [Cert. Tr. on App. 52].

(c) That on February 2, 1949, appellant filed a Designation of Record on Appeal [Cert. Tr. on App. 53].

These documents, certified by the Clerk of the District Court, are now before this Court, and are referred to in the Clerk's certificate in the *Printed Transcript of Record* [R. 171, 172]. If necessary, appellant will ask leave to print the same.

The record on appeal herein also is applicable to the appeal from the minute order. It may be considered therewith, if necessary. Rule 73g, Federal Rules of Civil Pro-

cedure, which provides that the record on appeal be filed and docketed within forty days, or within the extended time, not exceeding ninety days from the filing of appeal, applies only to District Courts. No such limitation is placed upon Appellate Courts who may disregard a tardy filing, since the time limitation for filing the record on appeal in the Appellate Court is not jurisdictional. (*Miller v. United States*, 117 F. 2d 256; *National Surety Corp. v. Williams*, 110 F. 2d 873; *Buchs v. Federal Land Bank* (9 Cir.), 146 F. 2d 934.) If it be held that there is no timely appeal from the formal order, we respectfully request this Honorable Court to exercise its discretion and consider the present record in connection with the minute order appeal. We however submit that the appeal from the formal order is timely, and that appellees' contentions are without merit.

II.

Appellant, as Purchaser of Assets Sold in Bankruptcy Proceedings, Became a Party to Those Proceedings and May Appeal From Any Appealable Order Injurious Affecting His Rights as a Purchaser.

Appellant is not a stranger to these proceedings. It was the purchaser of assets sold by the Referee in Bankruptcy.

It is well established that a purchaser of property sold in a Bankruptcy proceedings becomes a party to those proceedings, subjects himself to the jurisdiction of the Court, and may appeal from any final order injuriously affecting his rights as a purchaser. This rule is so well established that it admits of no doubt.

In the early, but leading case of *Blossom v. Milwaukee & C. R. Co.*, 68 U. S. 655, 1 Wall. 655, 17 L. Ed. 673, 674, the United States Supreme Court announced the foregoing principle which ever since has been followed.

Kneeland v. American L. & T. Co., 136 U. S. 89, 10 S. Ct. 950, 34 L. Ed. 379, following the *Blossom* case, states the rule thusly:

“It was adjudged in *Blossom v. Milwaukee & C. R. Co.*, 68 U. S. 1 Wall. 655 (17: 673), that a bidder at a marshal’s sale makes himself thereby so far a party to the proceedings that for some purposes he has a right of appeal. It was said by *Mr. Justice Miller*, in the opinion of the court, that ‘it is certainly true that he cannot appeal from the original decree of foreclosure, nor from any other order or decree of the court made prior to his bid. It, however, seems to be well settled that, after a decree adjudicating certain rights between the parties to a suit, other persons having no previous interest in the litigation may become connected with the case, in the course of the subsequent proceedings, in such a manner as to subject them to the jurisdiction of the court and render them liable to its orders; and that they may in like manner acquire rights in regard to the subject matter of the litigation, which the court is bound to protect.’ ‘A purchaser or bidder at a master’s sale in chancery subjects himself *quoad hoc* to the jurisdiction of the court, and can be compelled to perform his agreement specifically. It would seem that he must acquire a corresponding right to appear and claim, at the hands of the court, such relief as the rules of equity proceedings entitle him to.’ It follows from this decision that his right of appeal must extend to all matters adjudicated after his bid, *which affect the terms of that bid, or the burdens which he assumes thereby*, and which are not withdrawn from his challenge by the terms of the decree under which he purchases. . . .

“ . . . Deducible from these authorities, as applicable to the facts in this case, and supported by sound reasons, are the following propositions: First. A party bidding at a foreclosure sale makes himself thereby a party to the proceedings, and subject to the jurisdiction of the court for all orders necessary

to compel the perfecting of his purchase, and with a right to be heard on all questions thereafter arising, affecting his bid, which are not foreclosed by the terms of the decree of sale, or are expressly reserved to him by such decree. Secondly. Where not concluded by the terms of the decree any subsequent rulings which determine in what securities, of diverse value, his bid shall be made good, are matters affecting his interests, and in which he has a right to be heard in the trial court, and by appeal in the appellate court." (Italics ours.)

Williams v. Morgan, 111 U. S. 684, 28 L. Ed. 559, 565, follows the same rule. In *Harduval v. Mer. & Mech. T & S Bank*, 204 Ala. 187, 86 So. 52, the Supreme Court of Alabama states:

"A purchaser at a judicial sale, that is one whose offer to purchase is accepted by the officer authorized to make the sale, subject to confirmation by the Court in due course, acquires vested rights which are entitled to protection. Thenceforward he is a *quasi* party to the proceedings, is bound by the decree of confirmation or rejection, and subject to the orders of the Court with respect thereto. 16 R. C. L. 113, para. 81; *Haralser v. George*, 56 Ala. 295. He may, of course, appeal from any final order or decree injuriously affecting his right as purchaser. *Glennon v. Mittenight*, 86 Ala. 455; 5 So. 772; *Blossom v. Milwaukee, etc. R. Co.*, 1 Wall 655; 17 L. Ed. 673."

In *Turnball v. Mann*, 37 S. E. 286, 289, we find the following rule stated thusly:

"Such purchaser seems to be universally regarded as a party to the suit, and being such is liable to be bound both by the terms of the decree under which he purchased and by the subsequent decree of confirmation . . . or other orders touching the disposition of the property or the purchaser's liability for the purchase money . . . The decree complained of was a disposition of the money which Cole owed,

a direction how he should pay it. He could not disobey the order of the court and should be protected when he obeyed."

In *West Coast v. Radio Keith Orpheum Corp.* 70 F. 2d 621, 624, following the *Blossom* case, a purchaser was allowed to appeal. In *Strunk Lane and Jellico Mountain C. & C. Co.*, 64 Fed. Supp. 731, 733, a purchaser in Bankruptcy proceedings was held a party to the action and entitled to petition for review when aggrieved by the Referee's order. (To same effect: *Estate of Bradley*, 168 Cal. 655, 657; *In re Pearsons*, 98 Cal. 603 at 605; 4 Corpus Juris Secundum 381, par. 201; 3 Corpus Juris 652, par. 520; 2 Cal. Jur. 211, par. 53; 2 Rem. Bkpty. 61, Sec. 3757.)

This Court held that a person, though not a formal party to Receivership proceedings, may appeal from an order injuriously affecting his rights. (*Mitchell v. Lay* (9 Cir.), 48 F. 2d 79.)

Appellant is aggrieved by the Order appealed from. It directly affects the purchase, and appellant's rights as purchaser. It affects both the assets and the purchase price, to appellant's prejudice. The foregoing authorities hold this sufficient. The Order deprives appellant of assets and a credit allowed for undelivered assets. It determines the merits of the controversies between Receiver and appellant, and would be *res adjudicata* in any subsequent proceeding, thereby depriving appellant of its day in Court. To argue that appellant is not aggrieved thereby is sheer nonsense. Appellant was a party to, and participated in the hearings below. It was the purchaser at the sale [R. 4]; it appeared at and participated in the November, 1947, hearing [R. 72, *et seq.*] and at the hearing on the petition to compromise [R. 114, *et seq.*]; it was permitted to file a brief on Review [R. 44]. To claim that appellant is a "stranger" belies the record.

Further, appellant can maintain this appeal, because Receiver has refused to appeal from the District Judge's Order materially affecting appellant's rights, and with Receiver now in the camp of his late adversaries, unless appellant is permitted to prosecute this appeal, its rights cannot be protected.

Appellees' authorities are not applicable, or in point. They neither deal with a purchaser, nor with a purchaser's right to appeal. We submit that this appeal has been timely, and properly taken by appellant.

III.

Appellant's Relief Was Not Restricted to Rescission. The Representations of Receiver Entitled Appellant to a Proportionate Abatement of the Purchase Price for the Deficiency of Assets Sold but Not Delivered.

From a reading of Receiver's brief it would appear that first Receiver perpetrates, and now seeks to perpetuate a fraud upon appellant. He argues that appellant's sole remedy for Receiver's fraud was prompt rescission. He forgets that an inventory was presented to appellant by Receiver who represented "that naturally there would be adjustments on the merchandise used in connection with the operation of the business" [R. 89] which induced appellant's purchase; that when the merchandise was checked by Receiver's agent that "they pointed out it was short, and they would make it good" [R. 100]; that negotiations were pending to settle appellant's claims for shortages [R. 13, 14], which excused a prompt rescission, even if appellant had been restricted to that remedy. (*Frankish v. Federal Mortgage Co.*, 30 Cal. App. 2d 700, 709-12; *Eade v. Reich*, 120 Cal. App. 32, 38.) Because of representations by Receiver, appellant was not restricted to rescission. It was entitled to a proportionate abatement, or deduction from the purchase price for the deficiency in the

amount of property delivered. (See authorities O. B. 71.) It could be asserted as a defense to proceedings for the balance of the purchase price, or by other appropriate remedy (*Castleman v. Castleman*, 68 S. E. 34, 67 W. Va. 407; 50 Corpus Juris Secundum 628) and delay would not preclude this relief where no equities intervened. No person's rights can be injuriously affected by proportionate abatement as long as a purchaser retains sufficient of the purchase money out of which such abatement can be made. (*Castleman v. Castleman*, *supra*; *Marbury v. Stonestreet*, 1 Md. 147; 50 Corpus Juris Secundum 628; O. B. 71.) Appellees' own case, *Hall v. McGehee*, 37 F. 2d 854, states the very rule asserted by appellant as follows:

“ . . . On the contrary, he sought its confirmation and paid part of the purchase money, with knowledge of the shortage, after it had been confirmed. Under these circumstances, the utmost he could have asked in equity would have been a proportionate abatement of the purchase money, and this the referee gave him, based on his own estimate of the amount of goods that were short. (Citing cases.)” (Italics ours.)

Contrary to Receiver's contention the Referee in the foregoing case *allowed* the abatement, but purchaser claimed the allowance insufficient, and the review and appeal followed. The Circuit Court reinstated the *referee's allowance*.

The case of *Marbury v. Stonestreet*, 1 Md. 147, is so appropriate that we quote therefrom at length:

“ . . . In the case of *Hill v. Burkley*, 17 Vez., 401, it is said, ‘when a misrepresentation is made as to the quantity, though innocently, the right of the purchaser is to have what the vendor can give, with an abatement out of the purchase money, for so much as the quantity falls short of the representation. That is the rule generally, for although the land is not bought or sold professedly by the acre, the presumption is,

that in fixing the price regard was had by both parties, to the quantity which both supposed the estate to consist of. The demand of the vendor and the offer of the purchaser, are supposed to be influenced in an equal degree, by the quantity which both believe to be the subject of their bargain. Therefore a ratable abatement of price, will probably leave both parties in nearly the same relative situation, in which they would have stood, if the true quantity had been originally known.' This doctrine is recognized, and approved by Judge Story, in 4 *Mason*, 417. *We are aware of no reason why the same principle should not be applied to sales made by a court, whose duty it is to protect those who deal with it in good faith. In such cases, equity is done by making compensation out of the unpaid purchase money.* 2 *Har. and Gill*, 350, 358. It makes no difference whether the party making the statement, knew it to be false or not, provided it be of something forming a material inducement to the purchase, and by which the other party was misled to his injury. 'The gist of the inquiry is, not whether the party making the statement knew it to be false, but whether the stateemnt, made as true, was believed to be true, and therefore, if false, deceived the party to whom it was made.' (6 *Gill and John.*, 58. 1 *Md. Chan. Dec.*, 498. 1 *Story*, 195. . . .

The Court then reviews an argument similar to that advanced by appellees herein, and rejects the same, stating:

" . . . And to apply this reasoning to the present case, it may be said, that the inconsistency is more manifest when the vendee, instead of setting aside the sale, only asks that he may not be required to pay for more than he gets.

"*In such a case the purchaser does not ask that he may be discharged from complying with his contract. He claims an equity, growing out of a subsisting agreement, that the court with which he has dealt, cannot perform. The authorities say, that it is his equity to have what the vendor can give, and compensation, by way of deduction, for the deficiency.* . . .

“This seems to have been the practice in cases where the sale had been finally confirmed, but the proceeds not yet audited, and the accounts ratified. . . .

“We have seen that the right to relief in cases like the present, does not depend on a knowledge by the party making a misstatement, of its want of truth. It depends on its being untrue, and on the effect it may have had on the conduct and interests of the other party. The appellant avers, that he made this purchase upon a misrepresentation of the trustee, in which he confided, and by which he was misled to his injury. . . . But the circumstances shew, as we think, that the purchase was made, in a great degree, with reference to the quantity of land, and there is proof of a considerable deficiency, . . .” (Italics ours.)

The case of *In Matter of Salantkias*, 33 F. 2d 200, relied upon by both Receiver and Creditors, is not in point. *No representations* were made by the Receiver or Trustee therein, and the Referee found that *none* were made; the purchaser's testimony disclosed he *did not rely* upon the inventory; the order did not include “all inventory,” so of course “*caveat emptor*” applied. That decision (by District Judge) does not hold that rescission is the exclusive remedy. It holds that rescission is *available* to the purchaser. Other authorities cited by appellees likewise are not in point. None of them contained *representation* by Trustee or Receiver. In the instant case representations made were made by Receiver; the Order Confirming Sale included “all inventory”; the Referee expressly found that appellant relied upon the inventory in making its purchase, and had the right to so rely [R. 31, 33]. These factors, not present in authorities cited by appellees, rendering them inapplicable.

IV.

**Granting Relief to Appellant, by Way of Compromise,
for Receiver's Failure to Perform the Provisions
of the Order Confirming Sale Did Not Constitute
a Collateral Attack Upon Such Order.**

Appellees' claim of collateral attack ignores both the representations made by Receiver, and the terms of the Order Confirming Sale, which makes *payment and delivery concurrent conditions* and provides that Receiver sold "all inventory" together with all physical assets of Debtor *wheresoever situated*—"free and clear of any liens, charges and incumbrances" [R. 4-5]. Appellant contended that Receiver did not comply with the Order, but failed to deliver all assets bargained for, and that certain assets were not delivered "free and clear"; that therefore it should pay only for that received, and was entitled to an abatement of the purchase price to the extent that Receiver could not comply with the Order. This was proper (O. B. 71, and authorities under preceding Point). In this situation the following language of *Marbury v. Stone-street*, 1 Md. 147, is most appropriate:

" . . . when the vendee, instead of setting aside the sale, only asks that he may not be required to pay for more than he gets.

"In such a case the purchaser does not ask that he may be discharged from complying with his contract. He claims an equity, growing out of a subsisting agreement, that the court with which he has dealt, cannot perform. The authorities say, that it is his equity to have what the vendor can give, and compensation, by way of deduction, for the deficiency." (Italics ours.)

The Referee has the right to determine if the purchaser has received everything to which it is entitled to under the Order (*In re United Toledo Co.* (6 Cir.), 152 F. 2d 210), and if uncertainty exists in the Order, he can inter-

pret it and such construction must be followed (*In re Camden Rail and Harbor Terminal Corp.*, 120 F. 2d 1008). The direction in an order as to time and manner of payment are controlling (50 C. J. S., par. 306). Here payment and delivery were made concurrent. Receiver's failure to deliver all assets purchased entitled appellant to a proportionate abatement of the purchase price. Such determination is not a collateral attack. It is a direct proceeding to determine whether there has been performance of the Order by Receiver. Appellees' authorities do not involve a similar situation and are inapplicable. Appellees' "collateral attack" theory is untenable.

V.

The Doctrine of Caveat Emptor Is Not Applicable Due to Receiver's Representations and the Express Provisions of the Order Confirming Sale.

In seeking to apply "*caveat emptor*," appellees ignore important factors, *i. e.*, that the Receiver presented an inventory to appellant's agent before the sale [R. 86-87] and represented that there would be adjustments of merchandise used [R. 89]. Under these circumstances the doctrine does not apply. This rule is succinctly stated by the Supreme Court of California in *Webster v. Howorth*, 8 Cal. 21, 26, as follows:

" . . . It is said that the maxim '*caveat emptor*' applies to judicial sales, and that the defendant cannot avail himself of the misrepresentations of the plaintiff, as he had access to the records of the county, and might have informed himself upon the subject. Grant that the maxim *caveat emptor* applies to sheriffs' sales, it has never been carried to the extent that such a sale could not be impeached on the ground of fraud or misrepresentation. The maxim only applies thus far, that the purchaser is supposed to know what

he is buying, and does so at his own risk. But this presumption may be overcome by actual evidence of fraud, *or it may be shown that in fact the party did not know the condition of the thing purchased, and was induced to buy upon the faith of representations made by those who, by their peculiar relations to the subject, were supposed to be thoroughly acquainted with it.* The fact that the defendant might have examined the public records does not alter the case. Before such an examination could have been had, the sale would have been over, and he would have lost the opportunity of the purchase. *If, under these circumstances, he applied to the judgment-creditor for information, and, acting upon that information, was misled to his prejudice, he should be relieved, and the actual party in interest estopped from claiming an advantage, resulting from his own misrepresentations of facts, whether willfully or ignorantly made.*" (Italics ours.) (See also O. B. 68-71.)

Appellees' authorities, and those cited by the District Judge, indicate that there were no *representations* made by the Receiver or Trustee. This renders them inapplicable herein. Besides the Order Confirming Sale included "all inventory" among the assets sold. Its meaning was for the Referee to decide, and his determination is binding (*In re Camden Rail and Harbor Terminal Corp.*, 120 F. 2d 1008; *In re United Toledo Co.*, 152 F. 2d 210).

Our previous discussion concerning Rudolph's testimony is likewise applicable herein. If conflict or discrepancy existed therein, it was solely for the Referee to determine. On Review the District Judge was powerless to do so (O. B. 65, 67). It was error to apply the doctrine of *caveat emptor*, both because it was inapplicable, and because it was not a proper issue to determine on Review.

VI.

Even Where Evidence Is Undisputed, This Does Not Give the District Judge the Right to Reject the Referee's Determination as to Its Weight or as to the Credibility of Witnesses, or to Re-try the Factual Questions Anew, and Reject Such Evidence in Whole or in Part.

Appellees' briefs indicate that all factual questions before the Referee were not without conflict. Whether the sale was "as is" presented a factual question with conflicting versions, not only as to what actually transpired, but also whether such proceedings conflicted with the testimony of witnesses. The Referee's determination thereon was conclusive, both as to weight accorded the evidence, and as to the credibility of witnesses. Whether any discrepancy or conflict existed in the testimony was solely for the Referee to resolve, not for the District Judge (O. B. 65-68; *In re Cummings* (D. C. Cal.), 84 Fed. Supp. 65, 67; *Grace Bros. v. C. I. R.* (9 Cir.), 173 F. 2d 170, 173).

The Referee had his own choice not only as to the conflicting versions, but also could draw his own inferences from the undisputed facts (*In re Cummings* (D. C. Cal.), 84 Fed. Supp. 65, 67). These findings based thereon were conclusive upon the District Judge. Assuming that the evidence was undisputed, this would not permit the District Judge to disregard it for "it is axiomatic that uncontradicted evidence must be followed" (*Grace Bros. v. C. I. R.* (9 Cir.), 173 F. 2d 170, 174; *Powell v. Wunkes* (9 Cir.), 142 F. 2d 4; O. B. 65, 66). The District Judge *on Review rejected* the undisputed evidence and made findings directly contrary thereto, primarily based upon the unsworn statements and contentions of appellees' counsel. This he could not do (*Prentice v. Boteler* (9 Cir.), 141 F. 2d 175). In the cases cited by appellees the Court

accepted the facts as true, or they were agreed upon as in *Carr v. Southern Pacific*, 128 F. 2d 764. This permitted the Courts to draw their own conclusions of law therefrom. In the instant case the District Judge did not accept, but rejected, the undisputed evidence, and tried the factual questions *de novo*. He passed upon the weight of the evidence, and the credibility of witnesses. This was error (see O. B. 65-67).

VII.

Even Under Appellees' Theory the 25,807 Cases Were Not Sole "Free and Clear of Any Liens, Charges or Incumbrances."

Appellees state that the transaction between the bankrupt and customers concerning the cases was a "sale and return" but not a lien. This contention places the appellees squarely upon the horn of a dilemma. Either the Receiver had no ownership or interest in the cases to sell and therefore sold nothing to appellant, or else he sold them with a claim, charge or burden thereon, *i. e.*, the obligation to re-purchase the cases when and if requested by the customers, by repaying the 60 cent deposit previously given to and received by the bankrupt or Receiver. Certainly the Receiver intended to and did sell the cases "free and clear." Appellees do not contend otherwise. If he did not, then appellant was entitled to an equitable adjustment. Appellees' authorities indicate that the obligation to re-purchase the cases from customers constituted a burden or charge thereon.

A *charge* has been defined as a "lien, incumbrance, or claim which is to be satisfied out of a specific thing or person to which it applies" (Bouv. Law Dist.); also as "any burden or exaction; any onerous condition which is laid up or which can be borne or taken by a person or thing . . . and more specifically a burden, duty, obligation or

task laid or imposed upon a person or thing, an obligation directly bearing upon the individual person or thing to be affected" (14 C. J. S. 402). Clearly the term "charge" as used in the Order Confirming Sale comes within these definitions. The only exclusion was a certain conditional sales contract [R. 5].

A sale and return is a sale with an onerous condition subsequent. If appellees' authorities are applicable, then the cases were sold to appellant subject to claims by the customers for the 60 cent deposits when demanded, with the burden, obligation and duty upon appellant to repay the same. It becomes crystal clear that these cases were subject, either to a lien or a charge, as used in the Order Confirming Sale, and they were not delivered to appellant "free and clear" as required. This entitled appellant to a pro-rata abatement of the purchase price (50 C. J. S. 627; 656). We, however, adhere to our contention that these cases were subject to a lien (O. B. 72-75). Whether a deposit constitutes a sale, or a bailment subject to a lien, is a matter of *intent*. In all of appellees' authorities the deposit equalled the value of the property delivered. In the instant proceeding the cost of each case with bottles was approximately \$1.80 [R. 143]. Clearly the bankrupt did not intend to sell such case with bottles for any 60 cents. The fact that the word "60 cent deposit" [R. 156] was stamped on the cases would indicate a contrary intent, making the transaction a bailment, with a lien dependent upon possession in favor of the customer for the repayment of the deposit.

We neither deny nor dispute that a Bankruptcy Court may sell property "free and clear." This is not done when the property is in the possession of *adverse claimants*, and not the Receiver (Matter of Orpheum Circuit, 20 Fed. Supp. 101) and particularly, not without notice to the

lien holder (6 Rem. Bkptcy. 92, Sec. 2959; *In re Noel*, 137 Fed. 694). In any event possession of the property so sold must be delivered to the purchaser by the Receiver. This the Receiver, in the instant proceeding, failed to do. Possession of said cases could be obtained by appellant only by repaying the 60 cent deposit either by cash, credit, or exchange. Under the Order Confirming Sale, it was Receiver's obligation to deliver such possession to appellant "free and clear." While these cases remained in possession of the customers they were subject to repayment of the deposit before possession could be obtained. This constituted either a lien, or a charge, irrespective of what appellees may now contend.

In any event such issue was not before the District Judge for determination upon Review from the Order Approving Compromise. All that need to have been considered was that the Receiver would have met serious opposition in obtaining possession of the cases, without first repaying 60 cents to the customers. Appellees' position is untenable.

Conclusion.

We respectfully submit that for the reasons and upon the grounds herein, and in our Opening Brief set forth that the Order of the District Court reversing the Referee's Order Approving Compromise and Denying the same, be reversed with directions to affirm the Referee's Order Approving Compromise, together with appellant's cost of appeal.

Respectfully submitted,

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